The legal nature of debt securities in South African law

by

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PJ de Beer March 2021

SUMMARY

The problem statement of this thesis is ascertaining the legal nature of debt securities in furtherance of a consistent and coherent legal description of the South African positive law as it relates to this class of instruments. It focuses on four core issues: the legal history, legal nature, classification, and current legal issues relating to debt securities.

Historical and analytic-systemic approaches to the problem statement make up Part 1 of the study. The historical approach shows an emergent commoditisation of debt, which is an important phenomenon in the analysis of securities law. It further shows a great deal of English influence in the development of the South African legal environment, most notably in terms of company law (as the primary driver of securities law) and the financial marketplace, its institutions and its regulation. Also highlighted is a notable scarcity of debt securities relative to equities, which materially impacted legislative developments. Finally, it points to an increase in the legal importance of the "securities" concept as a legal term to describe and govern debt and equity securities.

Thereafter the analytic-systemic approach is used to identify a set of private law-rooted first principles applicable to South African registered securities, and therefore to debt securities as well. It posits that these securities should be understood conceptually as comprised two interdependent but functionally separate legal objects, rather than in terms of two different kinds of ownership (i.e. beneficial and registered). The first object is the "security instrument", a *locus* for (holdership of) the incidents that flow from the entitlement of determination (*beskikkingsbevoegdheid*) over the underlying complex of rights and competencies of registered securities. These can be understood as incidents of execution. The second is the "security asset", a locus for (holdership of) the incidents that flow from the entitlement of enjoyment (*genotsbevoegdheid*) over that underlying complex, and corresponds with the proprietary, patrimonial dimension of securities. These can be understood as incidents of enjoyment. This construction enables a more coherent understanding of the *sui generis* relationship of agency between beneficial owner and her nominee, as well as of the dynamics of ownership and *quasi-possessio*. These insights are then applied to the uncertificated environment, addressing a number of difficult and uncertain problems within the system that enables uncertificated securities and their holdership. Finally the particularly difficult issue of how to classify (and therefore identify) debt securities is dealt with. Here it is concluded that a typological approach is the only viable methodology to deal with this problem, and a number of necessary and thereafter possible classificatory *indicia* are outlined for this purpose.

The functional-policy approach makes up Part 2 of the study. It is a policy-aware application of the theoretical framework developed to a select number of themes and legal issues of the current environment. Principally it shows that the reconceptualisation of registered securities has explanatory and problem-solving value, specifically relating to transfer, the granting of limited real interests, good faith acquisition, and the protection of holdership of certificated and uncertificated securities.

OPSOMMING

Die probleemstelling van hierdie tesis is die vasstelling van die regsaard van skuldeffekte, ten einde 'n konsekwente en koherente regsbeskrywing te formuleer van die Suid-Afrikaanse positiewe reg soos dit betrekking het op hierdie klas instrumente. Dit word gedoen deur te fokus op vier kernaangeleenthede, naamlik die regsgeskiedenis, regsaard, en klassifikasie van skuldeffekte, asook die huidige regsproblematiek hierom.

Deel 1 van die studie vervat die historiese en analitiese-sistemiese benaderings tot die probleemstelling. Die historiese benadering wys op die voortkomende "kommoditisering" ("commoditisation") *van verbintenisse – 'n verskynsel belangrik tot die ontleding van die effektereg. Dit beklemtoon verder die wesenlike Engelse invloed in die onwikkeling van die Suid-Afrikaanse reg, veral in terme van die maatskappyereg (as die primêre drywer van ontwikkeling in die effektereg) en die finansiële markte, sy instellings en die regulasie daarvan. Verder word die noemenswaardige afwesigheid van skuldeffekte relatief tot ekwiteite uitgelig as 'n wesenlike beperkende faktor op wetgewende ontwikkeling. Laastens dui dit op die toenemende belang van die regskonsep van 'n "effek" vir doeleindes van die beskrywing en regulering van skuldeffekte en aandele.*

Die analitiese-sistemiese benadering word vervolgens aangewend om 'n stel "eerste beginsels" te identifiseer, gegrond in the privaatreg, wat van toepassing is op Suid-Afrikaanse geregistreerde effekte en dus ook skuldeffekte. Dit word voorgestel dat díe effekte konseptueel verstaan moet word as twee interafhanklike – maar funksioneel afsonderlike – regsobjekte*, eerder as in terme van twee verskillende tipes eienaarskap (i.e. voordelig en geregistreerd). Die eerste objek is die "effekte-instrument", 'n lokus vir (houerskap van) die uitvoeringsinsidente wat vloei vanuit die beskikkingsbevoegdheid oor die onderliggende kompleks regte en ander bevoegdhede van geregistreerde effekte. Tweede is die "effekte-bate", 'n lokus vir (houerskap van) die genotsinsidente wat vloei vanuit die genotsbevoegdheid oor daardie onderliggende kompleks, en wat ooreenstem met die eiendomsgeoriënteerde en vermoënsregtelike dimensie van effekte. Hierdie voorstelling illustreer 'n meer samehangende konseptualisering van die* sui generis *verhouding van agentskap tussen die voordelige eienaar ("beneficial owner") en haar genomineerde, asook van die dinamika van eienaarskap en quasi-possessio. Hierdie insigte word vervolgens toegepas in die "ongesertifiseerde" konteks ter adressering van verskeie problematiese en onsekere regsprobleme binne die stelsel wat ongesertifiseerde effekte en hul houerskap in staat stel. Laastens word die besonderse problematiek rondom die klassifisering (en derhalwe die identifisering) van skuldeffekte ontleed. Hier word die gevolgtrekking verdedig dat 'n tipologiese benadering die enigste haalbare metodologie daarstel om hierdie problematiek aan te spreek. 'n Aantal nodige en daarna moontlike* indicia *word geidentifiseer vir hierdie doeleindes.*

Deel 2 van die studie vervat 'n funksionele beleids-analise van die probleemstelling. Hierdie analise behels 'n beleidsbewuste toepassing van die teoretiese raamwerk wat ontwikkel is, inklusief vanom 'n reeks temas en regskwessies vanuit die huidige regsomgewing. Hoofsaaklik wys dit dat die

"herkonseptualisering" van geregistreerde effekte verduidelikend en probleemoplossende waarde het, veral soos dit betrekking het op oordrag, die skep van beperkte saakregtelike belange, ter goede troue verkryging en die beskerming van houerskap.

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CHAPTER 1

1 Introduction

1 1 Preliminary observations

Borrowing is one of the most important means by which firms and governments raise capital in the modern economy. Debt capitalisation can vary greatly in complexity and structure, but is typified by its larger scale as compared to retail borrowing as conducted by private individuals and small business concerns. Borrowing at scale can be achieved in three main ways: borrowing a large sum from a lender, borrowing a large sum from a syndication of lenders, or borrowing small to medium sums from a multitude of lenders. The last method requires a sophisticated market of many borrowers and lenders, operating within a reliable pricing environment and a stable transactional framework. Despite these complex prerequisites this kind of borrowing has become one of the most important and prolific features of the global financial system. It is enabled by the structuring of *loans* as *securities*.

The subject of securities is a vast, complex and nebulous field. It spans a multitude of disciplines, including mathematics, finance, economics, law, and even politics. In purely financial terms, a security can generally be thought of as a readily transferable *financial asset*.[1] However, in legal terms, the subject is more challenging.

At its core, a security is built on either a single personal right or a materially related set, or "bundle", of personal rights held by a security-holder as performance-creditor, and operative against the issuer of the security as performance-debtor.[2] What differentiates securities from other collections of rights held by a person (routinely encountered, for example, in complex contractual arrangements) is that these rights are structured, evidenced, and dealt with in a very specific way. Much attention has been devoted to this issue in the context of shares.

1 J Benjamin *Interests in Securities: A Proprietary Law Analysis of the International Securities Markets* (2000) 4.

2 See for instance K van der Linde & S Lutz "Aspects of the cross-listing of securities" (2009) 21 *South African Mercantile Law Journal* 631 631.

Yet the law as it relates to *debt securities* is rightly describable as a much "neglected area of South African law".[3] It is the aim of this work to address this issue in as much detail as possible within the confines of (1) the immense complexity and depth of this field from any disciplinary viewpoint (both domestically and internationally), and (2) a realistic view of the possible scope of the format of this dissertation.

At the outset, a foundational terminological observation is necessary. As will become clear in both the following section and throughout, the term "security" appears to have a contextually variable denotation in South African law. The full extent of what the legal term is meant to signify differs, often quite dramatically, depending on the legal rule or principle in question. Nonetheless, its ambit can be made manageable.

As a point of departure, the view is taken here that derivatives (such as options, futures and forward-contracts, or swaps) should not be regarded as securities in the true sense, despite their inclusion in the definition of securities in the Financial Markets Act.[4] Securities, for current purposes, should only include equity securities (such as ordinary or preference shares), and debt securities. This may seem controversial, but the defensibility of this position will become increasingly clear during the course of the dissertation.

On this basis, debt securities can be divided into three groups. First are company debt securities, typically referred to as bonds, notes, debentures or, in the context of securitisation, asset-backed securities, revenue-backed securities or collateralised debt obligations. Second are government and supranational debt securities, typically referred to as bonds or gilts, and Eurobonds respectively. Third are money market securities, which could include certificates of deposit, negotiable certificates of deposit, short-term bills, and commercial paper.

There are a number of ways in which debt and equity securities can be differentiated from one another, and in so doing grouped together by common characteristics. Important variations of this include groupings based on whether securities are: bearer or registered, tangible or intangible, divided or indivisible, and (quasi-)fungible or non-fungible.[5] The fungibility distinction is analysed in Chapters 5 and 6 for specific purposes, and fungibility is not useful for the present discussion. The divisibility issue is the focus of Chapter 4 and further discussed in Chapter 5,[6] and may similarly be ignored at this stage. It will also become obvious throughout that both of these distinctions are

3 A phrase borrowed, gratefully, from Prof R Wandrag in an internal report written as part of the completion of certain formalities with respect to this dissertation.

4 19 of 2012, s 1 v. "securities". The overreach of this Act's definition is also dealt with in more detail in the section below.

5 See for instance Benjamin *Interests in Securities* 32-36.

6 See Chapter 4 generally, and Chapter 5, § 5 1 (§ 5 1 2 & 5 1 3 specifically).

secondary considerations in understanding the legal nature of debt securities in South African law, and do not take any kind of systematised analysis forward in a meaningful way.

This leaves the tangible-intangible and bearer-registered dichotomies, both of which run along quite similar lines. Nonetheless the former is, in South African law, problematic and of little analytic use. In main, this is because the concept of a tangible security in the domestic legal system is fatally flawed.

It is trite that bearer securities are negotiable instruments. It is also clear that negotiable instruments are regarded as corporeal and *tangible* property despite being structured around obligations, which are regarded as incorporeal and *intangible* patrimony. Thus, at face value, it appears as though one must regard bearer securities as tangible securities. This is not so. In the law of negotiable instruments:[7]

> "[t]here is…an important measure of truth to these generalisations concerning the roles of property and contract; but they do not give the complete picture. Indeed, without qualification, they may mislead, because the truly distinctive and characteristic features of negotiability are exceptions to, or deviations from, basic principles of both the law of contract and the law of property."

The negotiability concept does not render a previously *intangible and incorporeal* obligation suddenly *tangible and corporeal.* Instead, the negotiability concept establishes a particular "nexus between the obligation and the document", allowing certain legal rules applicable to corporeal property (most notably possession, ownership and transfer by *traditio*) to be applied to that instrument.[8] It is crucial to understand that these rules of corporeal property law are applied directly to the *document* and have only indirect effect, by virtue of this nexus between document and right, on the *obligation* it embodies. This is because:[9]

> "such embodiment does not mean that the document constitutes (in the sense that it is) the right. In other words, *there is no complete merger between the right and the document.* The best illustration of [this] fact…[is that] if the instrument is accidentally destroyed, the right embodied therein does not come to an end."

This is also why negotiable instruments are also referred to as "documentary *intangibles*".[10] The rights, unlike their documentary instruments, remain intangible.

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7 DV Cowen & L Gering *The Law of Negotiable Instruments in South Africa: Volume One* 5 ed (1985) 12.

8 This was confirmed in *Randfontein Estates Gold Mining Co Ltd v Custodian of Enemy Property* 1923 AD 576 581-582, as quoted in Chapter 3, § 3 1 1 1. See also Cowen & Gering *Negotiable Instruments* (1985) 24.

9 Cowen & Gering *Negotiable Instruments* (1985) 26-27 [own emphasis].

10 R Goode *Commercial Law* 3 ed (2004) 476 [own emphasis].

Thus, with respect, it is submitted that it is incompatible with South African law to state, as it has been in England, that:[11]

> "[t]here is an important exception to the rule that securities are intangible. Bearer securities in their traditional form (i.e. in the absence of computerisation) comprise of pieces of paper…[and] the paper is treated by a legal fiction as *constituting* the debt. This means that bearer securities are tangible and, and therefore choses in possession."

Accordingly, the tangible-intangible distinction is of limited to no use. In stark contrast, the registered-bearer dichotomy avoids this issue altogether, and presents the most theoretically cogent basis for analysing the general legal dynamics of (debt) securities in the domestic system of law.

What is perhaps most in need of justification, however, is that (with the exception of Chapter 6) this dissertation will focus only on *registered* debt securities.

The designation bearer should be clear from the above – a bearer security is a security that is in negotiable form. Conversely, by way of an over-simplified introduction, a registered security is a security where holdership is *evidenced* but not *embodied* by either (1) if certificated: a physical certificate coupled with entry of the holder's details on a securities register; or (2) if uncertificated: solely by entry of the holder's details in an electronic ledger (which functions as the securities register) in accordance with the relevant legal requirements. As a result, transfer of registered securities occurs by replacement of the details of the transferor with the transferee on such a securities register, and, if certificated, the issue of a new security certificate.

It is tempting to justify such a narrowing of scope by arguing that bearer securities are a relative scarcity in the South African securities markets, existing at almost negligible volumes relative to registered securities. This is not an adequate reason for the omission of these securities from a dissertation ostensibly dealing with the "legal nature of [all] debt securities". The more compelling reason is that these securities are *theoretically* irrelevant.

At this stage, two types of debt securities identified above can be excluded entirely from the argument. The first is company securities. It is clear from the architecture of the new Companies Act[12] that companies must issue registered securities, and are no longer able to issue bearer

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11 Benjamin *Interests in Securities* 34. Whether this is the correct view in terms of its English law context is beyond the scope of this point, and unnecessary to pursue.

12 71 of 2008.

securities.[13] Second, the international class of Eurobonds are not only typically issued, held and traded in foreign jurisdictions, but are inevitably heavily intermediated. Any domestic issues they raise are either addressed in § 5 2 of Chapter 5, or are beyond the scope of this work, as the case may be. This leaves only domestic sovereign debt securities and money market securities which may potentially be issued to bearer. Bearer securities which have remained documentary (i.e. have not been dematerialised) will be dealt with first, and thereafter those that exist in dematerialised form.

Documentary bearer securities, quite simply, raise no contentious points of law. The South African law of negotiable instruments is clear, well developed, and leaves no ambiguity as to the legal issues involved in the creation, holdership, transfer, or other legal ramifications of bearer securities. In short their legal nature is clear, and there is little contribution to be made to the South African law in this area.

Dematerialised bearer securities are theoretically irrelevant for a very different reason – as shown in § 5 2 of Chapter 5, they are integrated into the dematerialised system by the creation of a secondary, representative *registered* security. Whatever the arrangements made in the Securities Services Act,[14] neither the currently operative Financial Markets Act, nor Strate Limited's central depository rules appear to maintain or evidence any differentiation between bearer and registered securities in dematerialised form.[15] The Act and Rules deal only with uncertificated securities, and the legislative framework does not countenance any form of true immobilisation.

This is probably a result of legislative path-dependency caused by the intercedence of a brief period of *putative* immobilisation of registered securities in domestic legal development. These developments saw the law moving from solely paper-based trading to the immobilisation brought

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13 Clear, for instance, from the wording of s 37(9), and the general scheme of s 49, s 51 and s 53 of the 2008 Act. Even under the regime of the Companies Act 61 of 1973 the issue of bearer securities was prohibited (unless issued pursuant to an exemption granted by the Treasury). This was due to the (still continuing) operation of s 15(2), (3) & (7) of the Exchange Control Regulations in GNR 1111 in the Government Gazette no. 123 of 1 December 1961, issued under the Currencies and Exchange Act 9 of 1933. See also Cowen & Gering *Negotiable Instrum*ents (1985) 256. See also JL Yeats, R de la Harpe, R Jooste, H Stoop, R Cassim, J Seligmann, L Kent, R Bradstreet, RC Williams, MF Cassim, E Swanepoel, FHI Cassim & K Jarvis, *Commentary on the Companies Act of 2008* Int-85 – Int-86 & Int-99 & 2-512.

14 36 of 2004.

15 See Strate Ltd Rules of Strate (Pty) Ltd [Reg. No. 1998/022242/07] (updated as per Government Gazette Number 40188 dated 5 August 2016).

In fact, the only mention of bearer securities in the entire FMA is an opaque reference in s 36(1), dealing with the powers of the Registrar.

about by the Safe Deposit of Securities Act 85 of 1992, to eventual dematerialisation.[16] Although this is dealt with far more fully in Chapters 3 and 5,[17] the outcome is that any characteristics of negotiability of dematerialised bearer securities is ultimately notional, as these securities are held and transferred by electronic ledger entry. Thus they are made to function in exactly the same manner as true registered securities.

For these reasons, there are no theoretical issues regarding dematerialised bearer securities because there are no dematerialised bearer securities functioning as such within the uncertificated securities environment.

Therefore, this work is limited, generally, to the legal nature of *registered debt securities*.[18]

1 2 Research problem

The object of the research is to establish a consistent and coherent legal description of the South African positive law as it relates to debt securities. This work focuses on four core issues: (1) the legal history, (2) the legal nature, (3) the classification, and (4) current legal challenges relating to debt securities. Subsequent chapters deal with each of these themes in detail, and there is some unfortunate but inevitable overlap in the exposition of the research problem here. For clarity, these issues will be presented below in a different order than they appear above as well as in the rest of this work.

It is vital to note that due to the similarity of debt and equity securities' treatment in South African law, it is the case that many of the outcomes of the research will be outcomes about securities at large, though the focus of application and consequences of these outcomes will remain on debt securities.

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16 Interestingly, the dematerialisation of sovereign and company debt securities only occurred in 2004 (see Chapter 3, § 3 2), but money market securities were dematerialised even more recently. Due to increased volumes of money market securities, Strate Ltd began settling new money market securities electronically in dematerialised form in 2009, although any existing securities were not dematerialised. Due to the short-term nature of money market securities, these older instruments have no bearing on the present issues.

See both Strate "Money market settlement services" <http://www.strate.co.za/processing-your-transactions/money-market-settlement-services> (last accessed 12-12-2016), and SAIFM "The Dematerialisation of Money Market Instruments" Financial Markets Journal 7 ed (2008) <http://financialmarketsjournal.co.za/oldsite/7thedition/dematerialisation.html> (last accessed 12-12-2016). See also Chapter 3, § 3 2 2 2.

17 See § 3 2 and § 5 1 of these chapters.

18 Thus, again with the exception of Chapter 6, unless the context indicates otherwise the term "security" or "securities" is to be understood to refer to registered securities.

The classificatory problem

An appropriate point at which to begin is the classificatory aspect of the research problem. The scope, complexity and significance of the global financial market, as a factual phenomenon, presents a unique set of challenges to the legal sphere. Primarily, in the "esoteric, fast-developing and highly-globalised world of the finance industry", typified by "fast developments of financial instruments, transactions and techniques",[19] the law is challenged to strike a very fine balance between a necessary certainty in its application, and an equally necessary flexibility vital, from an economic perspective, to the efficient and effective functioning of the financial marketplace. This is increasingly true as intangible assets become more and more important determinants of wealth within the broader global economy.

A great number of different financial products are created, utilised and traded within the financial sphere. From a taxonomical perspective, among this range of products lies the genus of *financial instruments*, within which, in turn, *securities* is encountered.

Financial instruments include shares, depositary receipts, debentures, interests in a collective investment scheme, a legion of different types of derivatives, certain negotiable instruments, as well as, potentially, a number of other instruments or "arrangements". Which of these instruments are securities for the purpose of the application of law?

At first glance, statute appears to provide the answer. In terms of currently enacted law, sections 1 of the Companies Act of 2008, the Financial Markets Act of 2012 ("FMA"), and the Securities Transfer Tax Act[20] ("STTA") all provide a definition of "securities". Yet each of these Acts defines the concept enumeratively rather than substantively, providing a list of instruments which are to be considered securities for the purposes and application of that particular Act. Central to the issue is that the definition in each act differs in scope.

The definition in the FMA reads (with own emphasis) as follows:

"**'securities'** means—

(a) listed and unlisted-

(i) shares, depository receipts and other equivalent equities in public companies, other than shares in a share block company as defined in the Share Blocks Control Act, 1980 (Act 59 of 1980);

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19 H Cousy "The delicate relationship between law and finance: the classification of credit default swaps" (2014) *Tydskrif vir Suid-Afrikaanse Reg* 227 227.

20 25 of 2007.

(ii) debentures, and bonds issued by public companies, public state-owned enterprises, the South African Reserve Bank and the Government of the Republic of South Africa;

(iii) derivative *instruments*;

(iv) notes;

(v) participatory interests in a collective investment scheme as defined in the Collective Investment Schemes Control Act, 2002 (Act 45 of 2002), and units or any other form of participation in a foreign collective investment scheme approved by the Registrar of Collective Investment Schemes in terms of section 65 of that Act; and

(vi) *instruments* based on an index;

(b) units or any other form of participation in a collective investment scheme licensed or registered in a country other than the Republic;

(c) the securities contemplated in paragraphs (a) (i) to (vi) and (b) that are listed on an external exchange;

(d) an *instrument* similar to one or more of the securities contemplated in paragraphs (a) to (c) prescribed by the registrar to be a security for the purposes of this Act;

(e) rights in the securities referred to in paragraphs (a) to (d), but excludes-

(i) money market securities, except for the purposes of Chapter IV; or if prescribed by the registrar as contemplated in paragraph (d);

(ii) the share capital of the South African Reserve Bank referred to in section 21 of the South African Reserve Bank Act, 1989 (Act 90 of 1989); and

(iii) any security contemplated in paragraph (a) prescribed by the registrar…"

The definition provided by the Companies Act states that:

"**'securities'** means any shares, debentures or other instruments, irrespective of their form or title, issued or authorised to be issued by a profit company…"

This must be read with s 43(1)(a) of the Act, entitled "[s]ecurities other than shares". This section uses "debt instrument" as its operative term, and states that:

"(*a*) "debt instrument"

(i) includes any securities other than the shares of a company, irrespective of whether or not issued in terms of a security document, such as a trust deed; but

(ii) does not include promissory notes and loans, whether constituting an encumbrance on the assets of the company or not…"

Lastly, there is the STTA, in terms of which:

"**'security'** means-

(a) any share or depository receipt in a company; or

(b) any member's interest in a close corporation,

excluding the debt portion in respect of a share linked to a debenture…"

From the above, shares are clearly securities. Yet for the purposes of the FMA, the shares of shareblock companies are excluded, whereas the STTA makes no such exclusion. Additionally, the latter Act also includes members' interests in a close corporation, but it is the only act to do so. Debentures and bonds (terms which denote the same type of instrument, and are legally indistinguishable)[21] are also clearly securities, yet they – in turn – are excluded from the STTA. The FMA does consider debentures to be securities, and goes much further, including also a range of other financial instruments. This forces one to conclude that whether a particular financial instrument is, or is not, a security is contextually variable, and contingent on the application of the act or legal rule in question.

However, this alone does not sufficiently resolve the matter. Both the Companies Act and the FMA contain plenary, catchall provisions when dealing with securities. In the latter Act, there is ss (d) and (e)(iii) of s 1 (*viz.* "securities"); in the former, s 43 ostensibly includes "any other securities other than the shares of a company". Other than the *eiusdem generis* canon of construction, there is nothing contained in the common law, nor any case law, that allows the law to make a satisfactory determination about whether a particular legal arrangement or interest will fall into this category.

The FMA contains by far the broadest definition of securities, including the category of derivatives.[22] This particular inclusion aptly illustrates this element of the research problem. The Act clearly states, *enumeratively*, that the term securities includes derivatives; yet, substantively, it is uncontentious to assert that not all (if any) derivatives are true securities in the manner in which they function or are structured. This is most obvious in the case of swaps, which operate to spread financial risk between two parties, who *each* hold both rights *and* duties in terms of their leg of such a swap.

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21 Therefore all references to this type of instrument will be limited to "debt securities" unless the context requires otherwise.

22 Which, interestingly, does receive a substantive rather than enumerative definition: see s 1 *viz.* "derivative instrument", which reads:

"**'derivative instrument'** means any—

(a) financial instrument; or

(b) contract,

that creates rights and obligations and whose value depends on or is derived from the value of one or more underlying asset, rate or index, on a measure of economic value or on a default event…"

There are strong arguments in favour of regulating certain types of swaps as insurance contracts rather than securities,[23] as well as some international debate as to whether swaps in general should be regulated as securities, forward-contracts or as *sui generis* instruments.[24] There is also general international consensus (at the very least amongst the Anglo-American oriented jurisdictions) that futures and other forward contracts are not true securities, although this consensus is fragile.[25] Options are another type of financial instrument (or derivative, as it is perhaps to be regarded as such) that illustrates the deeper problem. Certain options could be classified as securities (specifically: options to take up securities, often referred to in English-law influenced jurisdictions as warrants), whilst others could in all likelihood not be. However, as is shown in Chapter 6, this issue must be understood relative to the legal rule in question.

On a deeper level, the problem of derivatives reveals not only that securities can be, and are, differentiated from other similar financial instruments, but also that the term – in law – *must* be contextually variable. Hence a functional classificatory methodology must also, accordingly, be *teleologically flexible*. Further, it becomes obvious that this area of South African law is in great need of further development. As stated in the previous section, the FMA certainly overreaches in terms of its definition, but the crux of the problem remains.

The ability of the domestic law to make distinctions such as these is vital to its role in preserving systemic stability in the financial sector through effective, accurate and sometimes pre-emptive regulation and dispute resolution. Specifically, considering the prevalent risk of financial fraud or even the lesser systemic risks of mere financial irresponsibility,[26] the law must be certain. Conversely, however, in order to give meaningful effect to the economic policy objectives of financial and securities regulation, and (somewhat counter-intuitively) to prevent an uncertainty-driven chilling effect on healthy financial innovation, the law must be flexible.

In sum, South African law *must* be capable of classifying instruments as securities, and thereby identifying and distinguishing securities from other financial instruments. This is something which, at present, it does not have the tools to do adequately. Thus it is an aim of the dissertation to address

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23 Cousy (2014) *SA Merc LJ* 223-235, also discussing specifically Credit Default Swaps.

24 See for instance WE Gibson "Are swap agreements securities or futures? The inadequacies of applying the traditional regulatory approach to OTC derivatives transactions" (1999) 24 *Journal of Corporation Law* 379.

25 This is very well demonstrated in the context of anti-money laundering and the combating of the financing of terrorism (AML-CFT), where the difficulties in arriving at a common definition of securities across jurisdictions are set out and discussed at length in Financial Action Task Force *Guidance on Money Laundering and Terror Financing in the Securities Sector* (October 2009), at § 3.1-3.2, 14-17 & n 24.

26 Specifically regarding debt securities: see for example HC Nel *The Final Report of the Commission of Inquiry into the Affairs of the Masterbond Group and Investor Protection in South Africa* Vol 1-3 (2001), or essentially any informed account of the 2009 Financial Crisis.

this aspect of the research problem by developing a classificatory methodology that enables robust, consistent, and yet teleologically flexible determinations, especially in hard cases.

Historical developments

The second key element of the research problem is the legal nature of financial instruments that are already classified, or classifiable, as debt securities. This issue is the core of the overall research project. Without a functional understanding of the nature of debt securities, and to a lesser degree securities at large, neither an informed classificatory methodology, nor a deeper analysis of any of the current legal problems regarding securities can be achieved. However, to fully appreciate the nature of the modern debt security in South African law, the trajectory of legal development of securities and securities law over the course of the 19th and 20th centuries is a necessary prerequisite.

The value of the historical element of this work is not to be underestimated and should be introduced first. The modern debt security has its origins in the Italian city-states of the 1100s, where city-state governments first began issuing transferable, structured, fixed-interest debt instruments to their citizens to finance public expenditure.[27] By the 17th century, cities like Antwerp, Amsterdam and Paris began greatly to improve this "instrumentalisation" of debt, and build functioning markets around the concept.[28] However, for the purposes of South African law, the modern debt security and a recognisable securities market truly emerged in modern form in England shortly thereafter, building on these earlier and more prototypical developments on the Continent.[29]

At this time, securities were essentially still: (1) being used only for public (i.e. government-related) finance, and (2) overwhelmingly debt based. It was only upon the advent of the Industrial Revolution that large infrastructure, transport and mining projects gave rise to quasi-public corporate entities with financing needs similar in scope to those of government. In these new ventures the investing public was assured by the government-backed creditworthiness of these public enterprises (placing such debt, and then gradually equity, securities on a perceived equal footing with sovereign debt), and began increasingly to invest in non-government issued securities.[30] However, before 1856, limited liability through the corporate form was not freely available in England. Until then, incorporation by statute or charter was the only manner in which to imbue an enterprise with

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27 JB Baskin & PJ Miranti *A History of Corporate Finance* (1997) 35 & 37; and RC Michie *The Global Securities Market: A History* (2006) 17.

28 Michie *The Global Securities Market* 23-25; Baskin & Miranti *A History of Corporate Finance* 89; F Braudel *Capitalism and Material Life*, 1400-1800 (1973) 357-72, CP Kindleberger *A Financial History of Western Europe* (1984) 35-54.

29 JB Baskin "The development of corporate financial markets in Britain and the United States, 1600-1914: overcoming asymmetric information" (1988) 62(2) *The Business History Review* 199 206.

30 Baskin (1997) *Bus Hist Rev* 208; and Baskin *A History of Corporate Finance* 132-133.

corporate personality, freely transferable joint-stock, and limited liability. Yet more informal so-called “deed of settlement” companies (which were not true companies in the modern sense)[31] had already begun to take advantage of the public’s increased appetite for non-governmental investment by creatively emulating chartered juristic personality. In these developments lie the prolific rise of the equity security.

This is highly relevant to the South African legal position regarding securities. The concept of the *registered security* originated with these deed of settlement companies, to overcome inherent limitations to the transfer of personal rights (and thus the transfer of interests in these enterprises) in the English law at that time.[32] Such a transfer required an agreement of novation involving the company, the seller and the buyer. The direct and necessary involvement of the issuer in each transfer of its securities led, over time, to the development and use of a securities register. This register functioned to ease the administrative burden of novationary, tripartite transfer transactions.[33] More importantly, despite such securities becoming freely transferable shortly thereafter,[34] issuers (i.e. the company, either itself or through specialist service-providers acting on its behalf) persisted as the main administrative functionary of securities’ transfer, entrenching the use of a securities *register*. This development was, generally, not evident on the Continent, hence the registered security is an almost uniquely English law construct.

South African law, despite the Civilian character of its private law, directly adopted English company law legislation,[35] and from this also adopted the use of the securities (initially a respective share and debenture) register. A marked English influence is also evident in securities exchange law, domestically promulgated first in the Stock Exchanges Control Act,[36] and later amended by the Stock Exchanges Control Amendment Act.[37] Further, due to South Africa’s political history, the entire British institutional approach to securities markets and regulation was also instrumental in the development of the domestic dispensation. Thus it can be said that English law and practice has, historically, exerted a very high degree of influence in South Africa’s financial sphere, and the

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31 See generally LCB Gower *Principles of Modern Company Law* 5 ed (1992) 29-47.

32 Traditionally, the English common law did not allow legal assignment, but English law gradually came to recognise the (weaker) claim of equitable assignment in this context – see WS Holdsworth *A History of English Law* Vol 5 (1924) 299. It was only through s 25(6) of the Supreme Court of Judicature Act of 1873, and thereafter s 136 of the Law of Property Act of 1925 that legal assignment of choses in action, subject to strict formality requirements, was accepted. See Benjamin *Interests in Securities* 65-66 for an insightful summary of the above; as well as the work of E Micheler “English and German securities law: a thesis in doctrinal path dependence” (2007) 123 *Law Quarterly Review* 251.

33 See Micheler (2007) *LQR* 262-263

34 I.e. through English legislative interventions between 1844 and 1856 as per Gower *Principles* 29-47.

35 See for instance E De la Rey “Aspekte van die vroeë maatskappyereg: ’n vergelykende oorsig” (1986) *Codicillus* 4 4, 9 & 13-14, and JT Pretorius (ed), PA Delport, M Havenga & M Vermaas *Hahlo’s Company Law through the Cases* 6 ed (1999) 1, 2, 5 & 6.

36 7 of 1947.

37 86 of 1971 – the product of the “Broome Commission”, R.P. 47/1965.

emergent properties of the South African securities law system are decidedly English. In contrast to this system of evidentiary certification and registration, Continental securities are typically considered negotiable instruments,[38] and thus subject to the transfer requirements of *corporeal* property.

Developed securities markets, specifically those of the Continent and in England, were (and still are)[39] dominated by debt securities. This was not the case for emerging markets such as South Africa and Australia. These countries' early economies were primarily mining- and transport-driven,[40] and made use (by reason of English colonial influence) of a *branch* rather than *unitary* banking system which required far less liquid, i.e. invested-yet-readily-accessible, capital.[41] This, in conjunction with South Africa's rich gold reserves, dampened the demand for debt securities in the country, so that the South African capital marketplace heavily skewed towards equity.

Crucially, this trend caused legislative attention in South Africa to be devoted primarily to regulating *shares,* with little attention being given to what were then called "debentures" (i.e. debt securities). This trend is evident, even today, from various legal sources. First, it shows in the provisions of the Companies Act of 1926. It is also underscored by the detailed treatment of share-related issues and conversely scant detail on debt securities in the Report of the Company Law Commission of 1935-1936,[42] the interim and final 1948 Reports of the Commission of Inquiry regarding the Amendment of the Companies Act,[43] and the ("Van Wyk De Vries") Commission of Enquiry into the Companies Act.[44] It is also shown by the fact that there are only two significant South African reported judgments dealing directly with the legal nature of debentures – *Coetzee v Rand Sporting Club*,[45] and *Randfontein Estates Co Ltd v Custodian of Enemy Property*.[46] Neither are remotely recent. There is also precious little academic analysis of the domestic securities law environment that directly relates to debt securities.

Despite the share-centricity exhibited by South African law, the concept of *securities* grew considerably in legal importance during the 20th century in South Africa. This was accelerated after a sudden and significant up-tick in the volume and velocity of debt securities being actively traded

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38 See specifically Micheler (2007) *LQR* 251 *et seq.*

39 Baskin & Miranti *A History of Corporate Finance* 19. This fact is not always appreciated as equities often appear more prominent.

40 Michie *The Global Securities Market* 83-84, 92 & 111; Baskin & Miranti *A History of Corporate Finance* 143 & 144-145; and EC Kirkland *History of American Economic Life* 4 ed (1969) 304-307.

41 Michie *The Global Securities Market* 125-128.

42 U.G. No. 45, 1936 ("the Lansdown Report").

43 U.G. 78/48 and U.G. No. 69-1948 respectively ("the Millin Commission" – "interim Report" and "final Report") [own translation].

44 R.P 45/1970.

45 [1918] WLD 74.

46 [1923] AD 576.

between 1975 and 1990,[47] and this shift in focus deepened further as the market began assimilating new and hybrid financial instruments such as derivatives, interests in collective investment schemes and debt-equity instruments.

Understanding the effects of the rise of the more holistic *securities concept* in a share-centric legal environment is central to the research problem, as well as to its solution.

Put simply, debt securities were increasingly being regulated as “securities" and yet most securities-related legislation remained designed (at least primarily) with shares in mind. To understand why the securities concept had a fundamental impact on debentures, the manner in which the Companies Act 61 of 1973 defined debentures must be understood. This definition (virtually identical to the contemporary English equivalent) read:[48]

> “'debenture' *includes* debenture stock, debenture bonds *and any other securities* of a company, whether constituting a charge on the assets of the company or not…”

This definition followed the 1926 Act in using an “includes…” formulation, appearing as both nominal (referring to already established instruments by name) and enumerative (listing a number of these established instruments), rather than substantive (in the sense of providing abstract characteristics or guidelines to test a given instrument against). However, the definitional similarities between the two regimes end there. The key to this observation is the phrase “any other securities”, newly inserted, which represented a significant (yet perhaps at the time still not fully appreciated) shift in the legislature’s approach. As a point of departure, it can be said that the word “includes” shows that it was not a *numerus clausus*, and the phrase “other securities” points to a *eiusdem generis* interpretation that required, at least, a relationship of debt.

The Act did not define the securities concept save in s 134 (for the purposes of s 135-138 and 140 dealing with “listed shares or interests” and later also in s 91A and s 440A). In both cases it incorporated the definition in the Stock Exchanges Control Act.[49] The definition of this latter Act, as amended by the Stock Exchanges Control Amendment Act,[50] was obviously of very limited application within the overall framework of the Companies Act, dealing only with the transfer of listed

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47 M Bryant *Taking Stock: Johannesburg Stock Exchange – the first 100 years* (1987) 177. This was in all likelihood a function of the inflationary and interest-rate environment of that era. This trend appears to be continuing, although at a more stable rate than this initial explosion of the debt market. The impact of the (reasonably probable) impending and already underway credit-ratings downgrade of the ZAR may indeed further increase the volume, velocity and volatility of the domestic debt securities market.

48 Section 1 of the Companies Act 61 of 1973 [own emphasis].

49 7 of 1947 as amended. Again, this discussion of the Companies Act excludes the definition found in the later added s 91A.

50 86 of 1971.

securities. Assimilated from an act with a very different purposive bent, it was of little to no use in informing the *debenture* concept.

However, this "includes…and any other securities" construction indicates not only that all debentures were considered securities, but more importantly that *all* [company] *debt securities were considered debentures.*[51] MS Blackman et al, on the 1973 Act, describes a debenture as "…a written acknowledgement of debt, irrespective of its form, executed by the company, which may (but need not) include terms providing for the indebtedness to be secured by a charge over the property of the company."[52] This definition is, unfortunately, unhelpful in ascertaining the substantive properties of the modern debt security. Under a more rigorous analysis, the term debenture appears to have no ascertainable ordinary meaning, and if it did, that meaning would shift over time (as indeed the debenture concept has, and rightly should have, done). Furthermore, the present commercial reality ascribes little to no importance to the term debenture. The current Companies Act has replaced it with "debt instrument", and the JSE deals overwhelmingly in bonds and notes rather than debentures.

This leads to a more fundamental terminological point regarding the importance of the securities concept vis-à-vis the debenture concept. Under the 1973 Act, the operative *word* remained "debenture", but the operative *concept* had shifted to securities (due to "and any other securities") that are rooted in debt (due to the *eiusdem generis* rule) – i.e. debt securities. This had a profound impact on the legal meaning of the term debenture.

Historically, the debenture concept denoted only the (specialised) written acknowledgement of indebtedness, in accordance with the Blackman et al definition above. However, the securities concept denoted (and still denotes) a more holistic construct, including both the formal, documentary dimension of registered rights, *as well as* the substantive rights it is founded upon (the beneficial interest). The legal meaning of debenture had already begun to approximate the legal meaning of debt security, but the Companies Act of 1973 effectively (at least for the purposes of company law) married the two terms, to signify not only the accessory and documentary instrument, *but also the debt itself*. This trend culminates in the Companies Act 71 of 2008. The inclusion of the word "debenture" in s 1 (*v.* "securities") means little to nothing, as the overall scheme of the Act makes it

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[51] A Milne, C Nathan, KL Smith & PM Meskin in *Henochsberg on the Companies Act 61 of 1973* 3 ed (1975) argue at 218 that a "security" generally refers to an asset, and that – since a debenture constitutes a liability from the company's perspective – it generally means a "secured obligation" viewed from the perspective of the holder.

However they further argue that since debentures can also be unsecured, it is more likely that "security" merely refers to "…what is included in the term debenture [which] would also have its general meaning of an acknowledgement of debt". In other words, the term security really means any type of debenture, usually one which is secured. This, clearly, is a circular argument. See MS Blackman, RD Jooste, GK Everingham, JL Yeats, FHI Cassim & R de la Harpe *Commentary on the Companies Act: Volume 1* (RD 8 2011) 5-328 n 4.

[52] Blackman et al *Commentary* 5-327.

clear that the operative term for securities “other than shares” is “*debt instrument*”, as per s 43. Here the securities concept is even more significant, and yet it still remains ill-understood and uncertain.

Another particularly significant symptom of share-centricity in the securities concept is found in the advent of the uncertificated security. The attainment of the dematerialisation of listed securities began first with a brief period of immobilisation. Thereafter both the Companies Act of 1973 and the Safe Deposit of Securities Act (later known as the “Custody and Administration of Securities Act”)[53] were amended in 1998[54] to allow for the dematerialisation of securities. In principle, this facilitated a system whereby *all* listed securities could be centrally deposited, whether in certificated or uncertificated form. The change allowed for a parallel system of certificated and uncertificated deposit through various collective securities depository participants (i.e. approved intermediary depository institutions accepted as participants by the central securities depository).

In this system s 91A of the Companies Act served as the keystone of dematerialisation.[55] It applied only to “securities as defined in s 1 of the [then operative] Stock Exchanges Control Act 1 of 1985”, which *included* debt securities. Yet, s 91A fell under the sub-heading “*Shares (s 91-91A)*”. This new section was silent on the matter of the register of debentures as required by s 128 (then still a separate register to the share register). In Act 38 of 1998, it was provided that “‘uncertificated securities’…means uncertificated securities as defined in section 91A of the Companies Act…”.

This made s 91A the operative provision, incorporating the expansive definition of “securities” as found in the Stock Exchanges Control Act into s 91A by reference. Yet no further arrangements were made for the dematerialisation of debt securities in the amendment to the Companies Act. It was only in 2004, with the changes brought about by the Securities Services Act,[56] that company and sovereign debt securities were widely considered to be able to take uncertificated form. Money market (debt) securities, as noted in the previous section, were only dematerialised in 2009.

As long as the South African securities market was driven by equities, this would not (and indeed did not) lead to significant legal issues. The dominance of equities had mostly held true during the 20th century, continuously reaffirming company law as the principal source of best practice regarding key legal aspects of securities in general. Yet the expansion of the role of debt securities in South African capital markets towards the end of the 20th century, and the country’s persistently sub-par

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53 In 1992 the legislature enacted the Safe Deposit of Securities Act 85 of 1992 (known after its 1998 amendment as the Custody and Administration of Securities Act), allowing for the notional – as South African securities are not negotiable instruments – immobilisation of securities through collective deposit.

54 By Act 38 and 60 of 1998.

55 For a more detailed discussion of the details and operation of s 91A, as well as immobilisation and dematerialisation in general, see Blackman et al *Commentary* 5-200-1 to 5-238-1.

56 I.e. the precursor to the Financial Markets Act.

macroeconomic performance amongst its developing peers in the last two decades, raises questions as to whether the trend of primacy of equity will continue.

Then there is also the advent of the technique of securitisation (to which debt securities are central), the use of hybrid debt-equity and convertible securities, as well as new contractual financial instruments which have more in common with debt securities than equities. Such developments further indicate that there may be a very tangible future downside to the current lack of legal discernment and deeper understanding in the realm of debt securities. As the securities concept increasingly becomes the operative concept on which the application of legal rules (many of which are designed to protect the stability, integrity and functionality of the financial marketplace as a material element of the broader economy) rests, the law must be modernised and rationalised.

The legal nature of (debt) securities

With this in mind the third (and most significant) aspect of the research problem – the legal nature of modern debt securities – can be directly addressed. In light of modern developments, it becomes increasingly clear that neither the common law definition of debenture nor that of Blackman[57] remains appropriate or even sufficient. This is not only because the term has been effectively[58] removed from the Companies Act 71 of 2008, but also (more generally) as governmental and private issuers of debt securities have long since ceased to use the term debenture.

The logical question then becomes: what is the underlying structure, and corresponding nature, of the debt security? Again, history is instructive. Both the Companies Act of 1926 and 1973 obligate, in s 27 and 104 respectively, companies to recognise only the *registered* holder of a share to the exclusion of all others. From at least the early 20th century, debt securities (in order to function efficiently in the developing and equity-dominated secondary marketplace) began structurally to converge with shares, *emulating* the registered holdership of equities through provisions contained in the debt security itself, of which a typical example is:[59]

> "4. The registered holder will be deemed exclusively entitled to the benefit of this debenture, and the company and all persons may act accordingly. The company shall not be bound to enter in the register notice of or in any way to recognise any trust or the right of any person other than the registered holder to any benefit under this debenture save as herein provided."

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57 See *Randfontein Estates Co Ltd v Custodian of Enemy Property* 1923 AD 576 580 and the Blackman et al definition as quoted above.

58 The somewhat misplaced reference to "debentures" in s 1 *viz*. "securities" notwithstanding.

59 As per the Terms and Conditions of the R208 treasury bond.

This is not only true of corporate debt securities, but also of public-sphere debt securities such as Treasury bonds. For example, the Terms and Conditions of the National Treasury's R208 bond state:[60]

> "9.2 The Register of Bondholders shall:
>
> …
>
> 9.2.8 will [*sic*] only recognise a Bondholder as the owner of the Bonds Registered in that Bondholder's name as set out in the Register; and
>
> 9.2.9 shall not be bound to enter into the Register, the fact that a Bondholder may be holding Bonds in trust or as agent or mandatory for any third party and the Issuer shall have no responsibility whatsoever to such third party."

Through this structural convergence of debt and equity instruments, the separation between beneficial holdership and registered holdership became entrenched as a feature of all securities. The common underlying architecture also facilitates debt securities being held and traded in uncertificated form. Yet the legal interest underlying debt securities, and indeed every security or other financial instrument without an equity component, arises *contractually*, rather than by virtue of a constitutive quasi-contractual statutory instrument (i.e. the memorandum of incorporation).

Importantly, once a financial arrangement bestows on a particular party a legal interest which is classified – or classifiable – as a *security*, the content and import of that legal interest will also undergo further change. As a security, the underlying interest therefore also includes other rights and competencies[61] which arise *consequentially.* This is because, as a security, the positive law attaches additional content and consequences to that legal interest. Thus a central concern is the complex relationship between: the contract as the agreement constitutive of a security's underlying rights, the security's consequential rights and competencies, and registered (certificated or uncertificated) holdership. Each of these elements of a debt security must be understood as part of the whole.

Furthermore, the proprietary dimension of securities poses another unique problem when it comes to debt securities. But for the far-reaching English law influence on this branch of law, South African debt securities may well have developed as negotiable instruments, as is the case in Continental

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60 E Emmet *Pyemont's Company Law of South Africa* 5 ed (1940) 200 – an example chosen to illustrate that this development began early on, arguably originating in the 1926 Companies Act if not even earlier.

61 I.e. those benefits or other aspects of the underlying interest which cannot easily or uncontentiously be characterised as personal rights in the strict sense. The chosen term, *competency*, is thus meant to encompass all other terms such as capacity, power, non-subjective right, or privilege. For example, in the context of company securities specifically, voting rights or statutory remedial rights are seen as such competencies though they are commonly referred to as "rights".

jurisdictions with a similarly Civilian character, such as Germany and the Netherlands. But as this is not the case, the reception and perpetuation of English law principles and practices must accord with the mixed legal heritage of South African law. This is especially so in the context of *contractual* securities (such as debt securities), where the underlying bundle of legal interests is more directly subject to a Civilian system of private law.

Most pertinently, English law contains a distinction between beneficial (or equitable) ownership and legal ownership, and correspondingly reads a constructive trust into the relationship between the registered holder and the beneficial owner of a security. Neither dual ownership nor constructive trust is recognised in South African law.[62] Nonetheless, the (quintessentially English) distinction between registered title and beneficial ownership of shares has long been recognised and retained.[63] As a result, "[b]y approximating registered title and ownership to legal and equitable title respectively, the concept of the share as found in English law is at least superficially integrated into the South African legal fabric."[64] The contractual emulation of these arrangements by debt securities makes this equally applicable to *all* South African registered securities.

However, the doctrinal incongruity of this superficial reception causes persistent practical and theoretical problems and uncertainties.

In this light, a reconceptualisation of the underlying structure of debt securities is necessary. Most importantly, a uniform account of the nature and form of securities in South African law must be sketched – one which, because it is in harmony with the unique configuration of South Africa's residual Civilian-Common law mixed heritage, is legally consistent and has backward- *and* forward-looking problem-solving qualities.

Consequent application to extant legal issues

The outcomes of this more in-depth treatment of these issues must thereafter in terms of the fourth *problem-solving* aspect of the research problem, be tested against the current body of law. Here the central question is whether these outcomes elucidate currently unresolved, unclear or as yet unconsidered issues in the positive law as they relate to debt securities. It is unnecessary to canvas these issues, as they are dealt with at length in Part 2 of the dissertation.

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62 *Lucas' Trustee v Ismail and Amod* 1905 TS 239 247-248; *Princess Estate and Gold Mining Co Ltd v Registrar of Mining Titles* 1911 TPD 1066 1078.

63 See for instance *Farrar's Estate v CIR* 1926 TPD 501; *Jeffery v Pollak and Freemantle* 1938 AD 1 at 18; *West v De Villiers* 1938 CPD 96 at 102; *Moosa v Lalloo* 1956 (2) SA 237 (D); *Verrin Trust and Finance Corp (Pty) Ltd v Zeeland House (Pty) Ltd* 1973 (4) SA 1 (C); *Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd* 1976 (1) SA 441 (A); *Standard Bank of South Africa Ltd v Ocean Commodities Inc* 1983 (1) SA 276 (A).

64 A Borrowdale "The transfer of proprietary rights in shares: a South African distillation out of English roots" (1985) 18(1) *Comparative and International Law Journal of Southern Africa* 36 40.

Finally, in so far as was possible, much care was taken to ensure that the theoretical outcomes of this work should not be at odds with practice or commercial reality. It is hoped that the foundations have been improved with little to no damage to the structure that has been erected upon it.

1 3 Methodological considerations

A suitable methodological framework for this type of analysis is found in DV Cowen & L Gering's *The Law of Negotiable Instruments in South Africa.*[65] The authors identify four approaches which, because the nature of legal issues raised by negotiable instruments and debt securities show many similarities,[66] can be usefully applied to this research problem. The original formulation has been preserved as far as possible, but with certain necessary contextual changes for application to securities rather than negotiable instruments.

The first is an *historical approach*, premised on the notion that "in most legal systems, [the securities concept has] been a growth, rather than conscious or planned graft; and that depending on the issue involved, the legal system concerned, and even the time in which the observer lives, the rules governing [debt securities] may be seen to reflect important or drastic deviations from the ordinary principles of law."

The second is a *functional-policy approach*, with an "emphasis on the purposes or objectives of the [financial marketplace] during the great formative periods of the relevant law, and especially the various considerations of policy which, from time to time, influence legal systems in adopting certain solutions rather than others."

The third is a *comparative approach*, which due to its popularity amongst legal scholars requires no elaboration here.

Last is an *analytical-systemic approach*. This approach "focuses attention on how [debt securities] and the rules governing them fit into the overall system of private [and commercial] law…[and its] main concern is with 'legal dogmatics', and with analysis of concepts and their systemisation." Ultimately, in the context of analysing negotiable instruments, the authors favour a combined

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65 See 7-15.

66 See specifically Cowen & Gering *Negotiable Instruments* 7-8, where it is stated that:

> "[a]n understanding both of the 'negotiability concept' and of the nature of a 'negotiable instrument' is fundamental to the study of the rules applicable to the three specific documents regulated by the Bills of Exchange Act…Not only do these concepts give meaning and coherence to the rules applicable to bills of exchange, cheques and promissory notes, but, without a firm grasp of them, one cannot understand, less apply in practice, the detailed rules (both common law and statutory) which comprise the relevant body of law."

If one replaces "negotiability concept" and "negotiable instrument" with "securities concept" and "registered and beneficial holdership" respectively, it is difficult to formulate the current research problem in better terms than this.

approach. This approach is also favoured here, and informs the overarching structure of this dissertation.

Each of these approaches is used to address the various components of the research problem. This brings one to the order in which these four aspects of the research problem have been outlined in the previous section, and how this corresponds to the sequence of chapters that follows. The historical approach is utilised first, after which an analytical-systemic approach is used to outline both the legal nature and an appropriate methodology of classification of (debt and other) securities. Lastly, using the insights from these two approaches, the most relevant elements of the existing legal problems surrounding debt securities are dealt with, through the lens of the functional-policy perspective.

The comparative dimension of the research is not dealt with separately. Due to the unique mixed legal heritage of South African law, as well as the nature of the subject matter, legal problems centred around debt securities typically contain Civilian and common law (especially through legislation) elements. A dedicated, isolated comparative section or chapter will not yield readily applicable legal answers, and thus any comparative analysis which is undertaken is integrated into the dissertation, as and when appropriate.

PART 1

HISTORY AND THEORETICAL FOUNDATIONS

CHAPTER 2

2 A historical perspective on debt securities

The aim of this chapter is to provide a historical account of the emergence of debt securities both globally and in South Africa. Such an account is vital to an informed, coherent, and more accurate analysis of the legal history found in the following chapter. This chapter is divided into three sections.

The first considers the early emergence of securities and securities markets, from the earliest proto-debt securities in medieval Italy to the sophisticated and internationalised markets and instruments of the 20th century. The second centres on selected relevant developments in England. Most of the practices in domestic securities markets derive from England and it has been the biggest single contributor to the South African law on securities. The section focuses on the consequences of the English legal approach to property, obligations and corporate law, moves on to the decisive role of similarities in English and South African banking practices, and finally deals with the effect of past English regulatory attitudes on South Africa. The final section sketches the progression of the domestic securities sector. It deals with the development of securities before the 20th century, and thereafter the development of the modern position.

2 1 A global overview

Globally, debt securities are held far more widely than equity.[1] Seemingly, this has been true since the first instruments to resemble modern securities arose in the medieval Mediterranean. This is unsurprising. From an economic perspective, like all markets in the real world, securities markets are characterised by varying degrees of imperfection. The theoretical ideal of a perfectly competitive

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[1] JB Baskin & PJ Miranti *A History of Corporate Finance* (1997) 19.

market has never been achieved, and the efficiency of a given market is determined by the extent to which it approximates the standard of a perfectly competitive market. One of the key aspects of securities markets in particular is *risk*, a variable which is in many ways tied to market imperfection. Today's securities, although structurally similar, are not homogenous. Modern securities markets do not exhibit perfectly free entry or exit, an infinity of identical buyers and sellers, or, most importantly, perfect information.

It is submitted as self-evident that the more immature a market or set of markets is, the less it will resemble a perfectly competitive market environment. Put a different way, the more primitive a market is, the more *market imperfections* it will exhibit. In such imperfect markets, participants naturally react to these circumstances, exhibiting a preference for goods or services which mitigate the market's deficiencies.

This explains why debt securities remain more popular than equity securities.

Fixed income securities exhibit stable cash flows and minimal variations in underlying value, which make them more attractive to investors facing imperfect informational environments. This is because they are, as a result, easier to price. Equity instruments are particularly volatile, and therefore harder to price in imperfect informational environments. Among all fixed-income securities, *debt* instruments enjoy primacy, and their characteristics (for example fixed returns, stable asset value, real security, and an overall safer risk profile) made them not only more secure, but also easier to market.

Furthermore, as shown throughout this chapter, equity's rise to prominence in the investing world is a relatively recent one, whilst the concept of debt is arguably as old as money itself. For this reason, the institution of law did not historically imbue equity instruments with the same remedial safety (and therefore protection, for example from "overly sanguine" or fraudulent ventures) as their fixed-income counter parts.[2]

In sum, debt instruments are easier to price accurately, less volatile, and until recently offered more investor protection in markets where the price mechanism does not operate perfectly and can therefore not be totally relied upon.

For these reasons debt securities (or to a lesser degree securities that resemble or function like debt instruments, such as preference shares) were able to overcome the informational and structural defects of markets in earlier economic eras. As a consequence, markets for these securities became

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2 Baskin & Miranti *A History of Corporate Finance* 14-15 & 19; and JB Baskin "Dividend policy and the volatility of common stocks" *Journal of Portfolio Management* (1989) 15 19-25.

prolific and active far earlier and more readily[3] than instruments structured around ownership (in the colloquial sense), control and profit-sharing, such as joint stock and later shares.

This development history begins with the arrival of the first instruments comparable to debt securities in the Italian cities of the 11th century. Governmental institutions, rather than merchants, appear to have "invented" the debt security, using it as a means to finance public expenditure. At the time city states such as Venice and Florence implemented a number of fundamental financial innovations in their regional trading economy, which at that time had undergone somewhat of a re-invigoration. Gradually their policies and practices for raising of capital and dealing with risk began to inform the practices of other contemporary European centres of trade and finance.[4]

For current purposes, the most important of these commercial advances is the pioneering use of dynamic contractual techniques, such as early bills of exchange and promissory notes. This was made possible largely by the legal and commercial convergence of practice occurring in the medieval Mediterranean.[5] These mercantile financial innovations strongly influenced the public financing practices of Mediterranean states, notably the Genoese Republic, Venice, and Florence. The governments of these states increasingly began to experiment with structured debt instruments, to which their citizens could subscribe.

In a number of cases this type of financing even began to resemble joint-stock enterprises,[6] prompting a number of scholars to argue that the joint-stock principle itself has its legal origin in these schemes. This appears incorrect. As far as the developments in Italy are concerned, any such joint-stock characteristics in public finance arose as coincidental mutations of the debt-instruments that preceded them, and for various reasons did not give rise, through actual legal reception, to the modern method of raising capital through equity.[7]

Whilst isolated instances of fragmented and transferable *ownership* were indeed known by European business practitioners at the time,[8] the idea of raising capital from the many via public subscription

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3 Baskin & Miranti *A History of Corporate Finance* 19.

4 Baskin & Miranti *A History of Corporate Finance* 35 & 37.

5 D Puga & D Trefler *International trade and institutional change: Medieval Venice's response to globalization* (2012) Discussion Paper No. 9076, Centre for Economic Policy Research Discussion Paper Series, August 2012 (copy available at < www.cepr.org/pubs/dps/DP9076.asp >) 2.

6 Compare the description of Mediterranean proto-corporations such as the *compagnia* in Baskin & Miranti *A History of Corporate Finance* (at 38-40) to the emergence of guilds and regulated companies (at 55-60). Michie calls these earlier enterprises "joint stock companies" – RC Michie *The Global Securities Market: A History* (2006) 20 – yet Schmitthof authoritatively and correctly rejects this terminology (along with the entire Italian reception theory) in CM Schmitthoff "The origin of the joint-stock company" (1939) 3(1) *University of Toronto Law Journal* 74.

7 Schmitthoff (1939) *University of Toronto LJ* 79.

8 Baskin & Miranti *A History of Corporate Finance* 60; LCB Gower *Principles of Modern Company Law* (1992) 19-23.

came from these early city states. More importantly, it was achieved using debt. As RC Michie states:[9]

> "[i]f a particular event can be taken to represent the beginnings of the global securities market it was the forced *loan* that Venice imposed on its inhabitants in 1171–2."

At this time the Venetian state initiated a programme of compulsory lending from its citizens. The borrowing took the form of fixed-interest debt instruments ("*prestiti*"), without a set repayment date. This had two important results: (1) these proto-bonds became increasingly trusted to yield the promised interest; and (2) they began to be *traded* amongst Venetian citizens. Between the 13th and 14th centuries, the Venetian state unfailingly paid out the stipulated 5% interest per annum and as an investment the *prestiti* circulated across Europe. The spread was primarily driven by the international merchant banking network, which was dominated by the Italians. Other city-states implemented similar schemes, including Sienna and Florence. The latter city state took matters further, eventually restructuring the transferable, interest-bearing bonds they had issued into one consolidated negotiable "stock" in the 1340s.[10]

It is clear that from as far back as the 1100s, it became standard practice for Italian city states to use such publicly-subscribed debt instruments (loans which became known as "*montes*" subdivided equally into parts termed "*loca",* and widely seen as personal rights) to finance conflicts, colonial conquests, and even agriculture or construction at home.[11] Such publicly funded pools of debt were structured as perpetuities, and it was cardinal to their success to make these debt perpetuities *transferable,* in order to ensure they were attractive to subscribers.[12] It is therefore unsurprising that negotiability, one of the earliest legal weapons against market imperfections, became a common attribute of these instruments. Certain issuing city states had even begun to make use of a registry of creditors ("*cartulario*").[13]

This is the essence of the emergence of the first discernible debt securities. The influence of radical and lasting developments in merchant banking (most significantly the instrumentalisation of debt in the money markets through bills of exchange and promissory notes) spurred on further systemic financial innovations. As a result, the public and quasi-public sphere began to utilise similar

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9 Michie *The Global Securities Market* 17 [own emphasis].

10 Michie *The Global Securities Market* 17.

11 Schmitthoff (1939) *University of Toronto LJ* 76.

12 Michie *The Global Securities Market* 17. For these early developments generally see also therein cited E Miller "Government Economic Policies and Public Finance, 1000–1500" in CM Cipolla (ed) *The Fontana Economic History of Europe: The Middle Ages* (1972) 293-295 & 550; RC Mueller "Foreign Investment in Venetian Government Bonds and the Case of Paolo Guinigi, Lord Lucca, early Fifteenth Century" in H Diedericks & D Reeder (eds) *Cities of Finance* (1996) 71, 75-76 & 84.

13 Schmitthoff (1939) *University of Toronto LJ* 76. The negotiability of securities persists today as an attribute of a number of jurisdictions – see Chapter 3, § 3 2 1 1.

contractual techniques to draw investment from the public to finance capital intensive activities. In order for these cities' permanent funded debt to be attractive to the public, however, these debt instruments had to be both trustworthy and transferable. In solving these problems, the medieval Mediterranean city-states essentially created tradable, compartmentalised and commoditised debt – i.e. something very akin to the modern debt security.

As noted, the practice also spread north. There, the familiar features of modern debt securities and their markets began to develop from the end of the 17th century. These later advances built upon the early innovations of the medieval Mediterranean, but occurred in Antwerp, Amsterdam and France and England. During this period the imperfections of financial markets were also greatly improved upon,[14] and the securities market begins to look increasingly familiar.

Importantly, a formal distinction between commercial financing and the funding of state expenditure (i.e. corporate and public finance) was not a feature of these earlier Continental capital markets.[15] Not only did debt overshadow equity (an as yet unheard of concept in these capital markets), but almost all securities invariably also had a governmental or quasi-public dimension. Mirroring developments on the Continent:[16]

> "[a]nonymous public markets in England for securities first arose to trade government issues."

What this statement implies is three-fold. First, English government-issued securities were legitimate and advanced enough to be traded broadly and anonymously. Second, seeing as government rarely (if ever) issued proto-equity instruments, the overwhelming majority of these securities must have been debt securities. Third, the formation of such broad and anonymous markets must have required (1) a large number of different security-like instruments available to investors, and (2) a sustainable volume of such securities in circulation.

During this period the English greatly refined their use of securities. Most importantly, debt securities had to be transferable, and since obligations were not freely transferable, English debt securities

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14 Michie *The Global Securities Market* (2006) 23-25; Baskin & Miranti *A History of Corporate Finance* 89; F Braudel *Capitalism and Material Life, 1400-1800* (1973) 357-72, CP Kindleberger *A Financial History of Western Europe* (1984) 35-54. The developments of the United Kingdom are of particular importance in this regard. From a historical standpoint South Africa "inherited" these instruments and their institutions and usages during the nineteenth century and onwards as a result of this increased globalisation of financial markets. South Africa's close legal ties to the United Kingdom in this area (and commercial law at large) means that the legal regime that developed there – and of course the environment which shaped it – are of paramount importance in understanding the history of the South African dispensation.

15 JB Baskin "The Development of Corporate Financial Markets in Britain and the United States, 1600-1914: Overcoming Asymmetric Information" (1988) 62(2) *The Business History Review* 199 208.

16 Baskin (1997) *Bus Hist Rev* 206.

were classified as *chattels.*[17] The government (as the dominant issuer of securities) also began to improve its understanding of how to achieve monetary policy stability (including the interrelation between short- and long-term borrowing). It further responded to the needs of the investing public by adapting the contractual dispensations of securities to reflect investor preferences. As a result of this, and the influence of successful Dutch, French and Belgian precedents, from the start of the 18th century onwards the focus shifted to longer-term instruments, such as tontines, annuity contracts, bonds and lotteries.[18]

Securities also began to play an increasingly important role as instruments for the financing of commercial enterprises. However, the modern joint-stock corporate form – with limited liability and full juristic personality – is a product of the mid-19th century.[19] Before this, state intervention was integral to the creation, operation *and financing* of the type of business ventures requiring the participation of the investing public. This is for a simple reason: juristic personality was not, until the mid-1800s, attainable without Royal charter or an empowering Act of Parliament, which could only be bestowed by government.

Irrespective of whether these securities were debt or equity based, the vast majority of issuers were essentially parastatal enterprises. This implied a certain guarantee, reassuring the investing public. As a party with seemingly near-unquestionable creditworthiness and reliability, the state's close involvement reduced the public's perception of the risk inherent in these investments, ensuring such securities were easier to price, and generally less volatile. This is illustrated by the manner in which the initial involvement of government in the infrastructure boom of the late 18th and 19th century helped overcome public scepticism regarding commercial securities, and paved the way for corporation-based entrepreneurship free from case-by-case government sanction.

By this time the use of debt securities was reaching a modern degree of sophistication. Yet the securities issued by the government and its select few quasi-public firms (incorporated by charter or statute) remained overwhelmingly the only securities enjoying broad-based trust, and therefore popularity and dominance, among investors.

Towards the end of the 18th century there was a dramatic upswing in economic activity. This was mainly caused by technology-driven efficiency gains, structural improvements in organisational productivity, and the rise of free trade – collectively better known as the Industrial Revolution. The

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17 This granted these instruments negotiability – J Benjamin *Interests in Securities: A Proprietary Law Analysis of the International Securities Markets* (2000) 310 & n 35.

18 Baskin & Miranti *A History of Corporate Finance* 101; and PGM Dickson *The Financial Revolution in England: A Study in the Development of Public Credit, 1688-1756* (1967) 39-75.

19 See Gower *Modern Company Law* 37-47 for the legislative process resulting the in the attainment of freely available juristic personality, corporate form, and limited liability.

Revolution fundamentally changed the nature of England's capital markets. Britain became the world's leading economy, and steam energy in particular brought about immense development in transportation infrastructure, specifically in canals and railroads.[20] As a consequence, vast amounts of capital accumulated in Britain, and infrastructure projects (both at home and in its colonies) were legion.

The industrial boom brought with it the creation of a host of new enterprises, and consequently a large number of new investment opportunities. Yet at the start of the 19th century the indistinct relationship between public and commercial financing persisted. Railways and canals are highly capital-intensive public infrastructure projects (and also arguably locked in as natural monopolies). Therefore it is unsurprising that the British government again paired up with its wealthiest businessmen to provide such infrastructure. The government also, as always, secured its involvement by imposing heavy-handed prerequisites for the granting of charters or statutes of incorporation, especially regarding corporate finance.[21] These companies, in turn, were able to trade on existing trust in the markets through their quasi-public image.[22] Accustomed to investing in government-backed business opportunities, the investing public had in this way been introduced to, and learned to trust, investment in *commercial* enterprise on a larger scale.

However, by 1856, regulatory shifts had made the benefits of incorporation accessible to virtually anyone, allowing entrepreneurs and wealthy capital owners to loosen their ties with government. The attainment of freely available juristic personality and limited liability through the legislative interventions during the second half of the 19th century facilitated the formation of corporations no longer tied to government, but still able to contract and take on rights and duties in own capacity.[23] The corporate form had begun to gravitate away from its mercantilist origins.

Economic growth, and infrastructure development in particular, had remained strong. Thus newly formed, truly private, companies moved into capital intensive sectors such as railway, mining and canal building, beginning to make use of the existing securities market infrastructure to raise funds independently of government. Yet no matter how much legitimacy their new legal status granted their securities, they still traded in largely the same high-risk, low-information environment they had been in since the 17th century. The solution for these English firms was reliance on debt financing.

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20 Baskin & Miranti *A History of Corporate Finance* 127.

21 Baskin & Miranti *A History of Corporate Finance* 132 & 133; Baskin (1997) *Bus Hist Rev* 208-210; MC Reed, *Investment in Railways in Britain, 1820-1844* (1975) 76-98; and FA Cleveland & FW Powell *Railroad Promotion and Capitalization in the United States* (1909) 84 for a similar position in the USA.

22 Baskin (1997) *Bus Hist Rev* 208; Baskin *A History of Corporate Finance* (1997) 132-133.

23 Gower *Modern Company Law* 37-47.

The British railroad industry was especially competitive, characterised by large regional firms which were built up through the gradual consolidation of many small, independent lines.[24] Imperfect markets for securities and the competitiveness of the railroad industry (increasing the risk of investing in one firm among many) reinforced amongst financiers and investors the belief that debt was preferable to equity. Debt, which generally confers no participation or residual rights, also has no effect on ownership-control dynamics.

However, despite these instruments' structural and nominal similarities to sovereign securities, the core concern from an investor's perspective remained credit risk, where the government retained an edge. Therefore, to ensure the competitiveness of their securities relative to those of government or quasi-public enterprises, private companies issued instruments which approximated the characteristics of these competing securities. Most importantly, firms provided real security in the form of a fixed or floating charge over some or all of the company's assets, in order to simulate the trusted creditworthiness of the state.[25]

It is also for this reason that early legislation dealing with company debt securities was primarily focused on real security arrangements.[26] Tradability – a central feature of modern debt securities – was still a secondary consideration, and the policy-stance of legislative intervention reflected this. Although real security enhanced tradability (as the creditworthiness of the instrument is a material consideration in secondary market transactions), securities' usefulness in the primary market (capital raising) remained their principal function.

As the 20th century approached, securities markets had not only become far more accommodating and trusting of commercial securities, but the sharp modern divergence of public and corporate finance had begun to emerge. By the middle of the 19th century England's securities market consisted of numerous satellite markets led principally by London,[27] and had grown from a small, incidental feature of the financial marketplace to a large and powerful force within it. It was no longer merely a stabilising augmentation to the money market, nor an adjunct of government borrowing. The securities sector had become a self-sustaining and important element of the capital market as a whole, having moved:[28]

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24 Baskin & Miranti *A History of Corporate Finance* 153.

25 See for example Baskin (1997) *Bus Hist Rev* 215-218; and Baskin & Miranti *A History of Corporate Finance* 146-151; as well as the numerous authorities cited therein.

26 See Chapter 3, § 3 1.

27 Places such as "Glasgow, Edinburgh, Manchester, Liverpool, Leeds, Birmingham, and Bristol" – Michie *The Global Securities Market* 76.

28 Michie *The Global Securities Market* 83.

> "out of the realm of government debt and entered the mainstream of economic activity, becoming increasingly central to the processes whereby business obtained finance, banks balanced risk and return, and investors employed their savings."

It was from this point forward that two deeply important developments caused an unprecedented global integration and proliferation of securities. These were the telecommunications revolution (most importantly the telegraph), and the ultimate acceptance of commercial debt and equity instruments as equally suitable investments in comparison to government debt securities. From 1850 onwards, securities exchanges also began to spring up outside of Europe and North America. However, these "new world" markets differed in two important respects from those of Britain and Europe. First, there was a far greater emphasis on commercial financing. Second was a strong preference for equity, especially in the mining and public transport sectors, being these markets' staple industries.[29]

None of this, however, had changed the fact that securities remained until the 20th century primarily a tool for raising capital. Securities were viewed as issuer-centric devices for financing large business ventures, and the investor-centric emphasis on trading, wealth- and portfolio-management had yet to come to prominence. Recognisably modern, broad and near-perfect markets for securities, operating at high volume and velocity, only arose during the 20th century. Trading activities only became genuinely important during this period, and it is no coincidence that securities law (and regulation) also only came into its own in the latter half of the 20th century.

Over the course of the 20th century the focus shifted from out-and-out investing (i.e. buy and hold for return on capital) to securities trading (buy and sell to maximise variable portfolio gains). In addition to the increasing structural reliability of the secondary market, this was brought about by: the specialisation and perfection of exchange-industry techniques, increasing globalisation in finance and commerce, the introduction of electronic trading, immobilisation and dematerialisation, the rise of derivatives and securitisation, and the telecommunications revolution.

On a more macroeconomic level, the fall of the Gold Standard, the end of the Bretton-Woods system, as well as the oil price shocks of the 1970s and concomitant new inflationary environment all contributed to a gradual change in the role played by debt securities within the global financial context in this pivotal 100 years. Where they originated as financing tools, to be held by the investor until maturity, they have become tools for the securitisation of fixed-income bearing assets of many classes, the levers of exchange- and interest-rate arbitrage, hedging instruments, leveraging tools,

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29 Examples include the United States, South Africa, Rhodesia, Australia, New Zealand and a number of South American countries. See Michie *The Global Securities Market* 83-84, 92 & 111; Baskin & Miranti *A History of Corporate Finance* 143 & 144-145; and EC Kirkland *History of American Economic Life* 4 ed (1969) 304-307.

investments traded at high velocity and volumes for marginal profits, and even significant economic indicators.[30]

As will be shown in the following chapter, legal development has, over time, reflected this change. However, the law generally eschews radical or speedy change, and typically develops in a path-dependent manner. The speed at which the modern financial marketplace developed has, therefore, caused it to fall mainly to legislation (as, arguably, the source of law capable of the fastest systemic change) to address this rapid evolution. Despite this, enacted law always relies on the existing body of more static positive law, less capable of such systemically radical change, to give meaning and effect to its objects. It follows that many legal aspects of debt securities are not directly addressed by statute.

This illustrates a problem typical of financial law. Statutory provisions, often incorrectly, assume doctrinal coherence with the broader legal system and evolve without a matching development of the sources of law that support them. The mixed legal heritage of South Africa has compounded this – many of the traditionally civil aspects of the private law are not readily compatible with the received content of the English common law in the companies or securities field. To understand the intricacies of the current regime, one must understand its past.

To complicate matters further, the global and domestic financial system *continues* to change rapidly. The most recent globally significant development was the rise and fall (and perhaps rise again) of complex asset securitisation techniques, which played a leading role in the financial crisis of 2009. Debt instruments are essential, if not central, to the process of asset securitisation, and almost all asset-backed securities (ABSs) are debt securities.[31] Yet, since at present the global financial system is still contending with the fallout of this event, this section concludes here.

2 2 Observations regarding the English securities environment

The English legal approach to commercial securities had a profound impact on the South African system.[32] In this section, certain preliminary comparative observations regarding the English law on securities (and its developmental environment) are made, so as to highlight its profound influence on the resulting South African dispensation. The purpose of this specific analysis is to show how

30 See for instance the functions of securities discussed in Benjamin *Interests in Securities* 5-8.

31 Such as mortgage backed securities (MBSs), collateralised mortgage obligations (CMOs), collateralised bond obligations (CBOs) and the many others that emerged in more recent years.

32 See also, generally, Chapter 3, § 3 1.

legal norms persistently influenced extra-legal institutions, and conversely how financial institutions and practices in turn also shaped aspects of the law.

2 2 1 Real rights, personal rights, and the securities register

Fundamental to the distinctive character of English law is its approach to real and personal rights, and the consequent development of the securities register. Regarding real rights, unlike Civil law Continental counterparts such as the Netherlands or Germany, the English system does not recognise the vindicatory action. This is because, more foundationally, real rights are not in principle enforceable against "all the world" and the English common law does not contain a principle whereby dominium over a thing operates universally. Instead, the common law only solves bilateral "priority" disputes regarding title, determining only the legal position between parties to a dispute, on a case by case basis.[33]

The Roman-Dutch underpinning of South African private law gives its property law a Civilian character, which does allow, for instance, universal dominium against third parties, the *rei vindicatio* for corporeal things and the *quasi-rei vindicatio* in certain circumstances for quasi-real rights (and perhaps certain other incorporeals).[34] Whilst legal development in (Continental) Civilian jurisdictions has systematically afforded more protection to bona fide acquirers, eroding some of the operation of the vindicatory action, South Africa has retained a stricter protection of dominium in this regard. This has a fundamental impact on securities. However much as they are bundles of personal rights, there is far greater emphasis on their proprietary dimension, as constituting movable incorporeal *property*.[35]

These divergent property law dispensations determine, on first principles, whether property rights are enforceable universally against third parties, or merely subject to "stronger" and "weaker" claims in title *inter partes*, as per the South African and English dispensations respectively. This highlights

33 S Worthington *Personal Property Law* (2000) 457-458 and M Bridge *Personal Property Law* (2002) 162-164.

34 CG Van der Merwe *Sakereg* (1979) 3-9 (character and origins of South African property law), 11 (the principle of absolutism, and the corresponding effect of the vindicatory action), 28 and 109-110 (quasi-possession of incorporeal things); AJ van der Walt & GJ Pienaar *Introduction to Property Law* 5 ed (2006) 3-8 & 13-14 & 156-172; and PJ Badenhorst, JM Pienaar, H Mostert & M Van Rooyen *The Law of Property* 4 ed (2004) 19-30 (the nature and doctrinal basis of property) and 51-73 (nature of real rights, and absolute enforcement) and 223-228 & 236-241 (the *rei* vindicatio).

35 In England, securities are of course also considered property, but it is the divergent legal consequences of something being property in the two systems (the originating system being England, and the derivative system South Africa) that are important here. Much like its contemporary English counterparts, s 22(1) in Chapter II of the Companies Act 46 of 1926 expressly made provision for the fact that "shares or any other interest which any member has in a company" are to be regarded as *movable property*, as did s 91 of the Companies Act 61 of 1973, and so also does s 35(1) of the Companies Act 71 of 2008.

The interrelated property and obligationary aspects of the law are further discussed in the following two Chapters.

a fundamental difference in how securities are treated in South African law vis-à-vis the system from which its securities concept was received.

In the English securities context, without recognition of a vindicatory action, entry on the securities register serves merely as an indication of stronger title in a particular legal dispute. Contrastingly, in the context of shares the South African courts have recognised that a quasi-vindicatory action is in principle possible.[36] The restored possession in question, it seems, is *being on the applicable securities registe*r, and not possession of the security certificate (as it serves more of an evidentiary function). It seems a quasi-vindicatory action in this context amounts, underwhelmingly, to one of the ways in which a beneficial interest holder may regain the ability to exercise her rights. This is effected through restored quasi-possession in the form of reflection of ownership on the register.

Differences in the applicable legal dispensation regarding personal rights, or more broadly obligations, is equally important. A fundamental developmental distinction between the English common law and the more Civilian tradition of South African private law is the approach to assignment.[37] Historically, in English law debt was initially seen as a personal obligation which could not be transferred. Gradually the law began recognising the assignment of choses in action – first only as a weaker claim in *equity*, but after 19th century statutory intervention enabled *legal* assignment as well (although subject to strict formality requirements).[38] However, during these earlier developmental years choses in action were, in the absence of empowering (incorporating) legislation or status as chattels, not transferable without the assent of the corresponding holder of the duty (the debtor). This remains at least partially true.[39] It follows that *debt securities* (with the exception of those of incorporated companies, the Monarchy and the state) could not be transferred without the consent of the issuer.[40]

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36 *Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd* 1976 (1) SA 441 (A) generally as well as 462, and *Standard Bank of South Africa Ltd & another v Ocean Commodities Inc & others* 1983 (1) SA 276 (A), specifically 290 & 294; and RN Eskinazi "The protection afforded in South African law to a purchaser of listed securities on the Johannesburg Stock Exchange" (1989) 1 *SA Merc LJ* 145 149-151. This is the primary focus of Chapter 11 of this work.

37 "Assignment" in the broad sense – to denote cession, as well as delegation and true assignment.

38 First through s 25(6) of the Supreme Court of Judicature Act of 1873, and thereafter s 136 of the Law of Property Act of 1925.

See, generally, WS Holdsworth *A History of English Law* Vol 5 (1924) 299; and Benjamin *Interests in Securities* 65-66.

39 G Tolhurst *The Assignment of Contractual Rights* (2006) 212, generally; specifically in the context of debts cf. *Ellis v Torrington* [1920] 1 KB 399 410-411, CA and for a broader policy perspective *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd* [1994] 1 AC 85, HL.

It is understood that the point made above is greatly simplified, as it is not necessary to give this aspect any detailed or nuanced review here.

40 E Micheler "English and German securities law: a thesis in doctrinal path dependence" (2007) 123 *Law Quarterly Review* 251 262.

As English commercial minds became aware of the benefits of formal incorporation, attempts were made to simulate its effects through the law of trust and partnership.[41] After the passage of the Bubble Act in 1720,[42] the number of such unincorporated enterprises ("deed of settlement companies", functioning more like partnerships than modern companies) steadily increased. This persisted until the legislative intervention of the mid-19th century made incorporation freely available by registration. A major legal obstacle to fully simulating incorporation remained the free transferability of members' interests. Still regarded as personal rights, they were subject to the same problems of *delectus personae* as debt securities. Companies formally incorporated by Charter or statute (i.e. true incorporation) did not have this problem, as their statutory founding instruments functioned to circumvent the common law in this and other matters.[43]

The English solution to this legal problem was creative use of *novation*, rather than assignment. The transfer of debt securities as well as members' interests would take place via an agreement of novation between the issuer, the transferor and the transferee. It effected the extinguishing of the old bundle of obligations, and a creation of a new set of identical obligations, so that the new holder was effectively put in the position of the old, exiting holder.[44] The South African approach to assignment is quite different – in principle the *cession* of a debt may occur without notice,[45] a transfer document,[46] or the consent of the debtor.[47] As such, debt instrument holders' interests are in principle freely assignable. Yet, perhaps even as late as 1973, this seems not to have been fully understood by the domestic legal system.[48]

The important point, nonetheless, is that in England this direct and necessary involvement of the issuer in each transfer of its securities led, over time, to the development and use of a securities register. It functioned to ease the administrative burden of these novationary, tripartite transfer transactions. More importantly, although such securities became freely transferable,[49] the issuer (i.e.

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41 Gower *Modern Company Law* 29-33; and generally F Evans "The evolution of the English joint limited stock trading company" (1908) 8(5) *Columbia Law Review* 339; HA Shannon "The coming of general limited liability" *Economic History* (1931) 2(6) 267; and S Williston "History of the law of business corporations before 1800" (1888) *Harvard Law Review* 2(3) 105.

42 6 Geo I c 18.

43 "Although the transferability of shares was in practice procurable under a skillfully drafted deed of co-partnership, its legality, except under a power expressly conferred in a charter, was not free from doubt, for *choses-in-action were not assignable at common law*." – Gower *Modern Company Law* 22 [own emphasis].

44 Micheler (2007) *LQR* 262-263 and Benjamin *Interests in Securities* 64-70 – "negotiation" is, of course, the third manner in which free transferability may be effected, but this was simply not the route of development taken for commercial securities in England.

45 *Brook v Jones* 1964 (1) SA 765 (N).

46 *Trust Bank of Africa Ltd v Standard Bank of South Africa* 1968 (3) SA 166 (A) and *Botha v Fick* 1995 (2) SA 750 (A).

47 *LTA Engineering Co Ltd v Seacat Investments Ltd* 1974 (1) SA 747 (A).

48 See Chapter 3, § 3 1 for detailed analysis of this.

49 I.e. through the English legislative changes after 1844 enabling the free obtainment of juristic personality.

the company, and later specialist service-providers acting on its behalf) persisted as the main administrative functionary of securities' transfer, occurring through the use of a securities register.

In this way the securities register (1) had become a permanent feature of English company law; and (2) ensured that a system interposing the issuer (to destroy the old, and issue the new certificates as well as amend the register) between the buyer and the seller had prevailed.[50] This, in sum, is the origin of *registered securities*. In contrast, the Continental trend in solving the transferability problem was the use of negotiability, as is for example evident in Germany's securities system where almost all were bearer securities.[51]

This highlights a curious feature of South African securities law. In the South African securities environment, the use of English principles, practices and institutions caused these English structural legal features, and thus the prevalence of registered securities, to persist.[52] This is despite the system being welded onto a legal chassis which has out-and-out dominium over property, a far freer system of cession, and far fewer consequential doctrinal complications regarding transfer or ownership. Nonetheless, as is often the case, certain legal usages transcend their original purpose and take on new, wholly justifiable roles. The securities register and certificate[53] are good examples – today, they serve many important functions including publicity, disclosure, protection of bona fide acquirers, as well as facilitating the exercise of the rights of registered holders.

2 2 2 The role of the banking sector

The structure of the securities exchanges and custody and administration systems operating in various countries differ widely, and highly influential institutional determinants of this divergence are the roles of government and the banking sector. In Anglo-American jurisdictions, trading infrastructure was largely self-regulated (or perhaps more accurately, unregulated), whilst in Europe the trend (not without its exceptions) leaned towards more intervention by government.[54] Two

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50 Micheler (2007) *LQR* 262-265 (§ 1.4.1 & 1.4.2).

51 See Micheler (2007) *LQR* 262-264 & 272-276; HD Jencken "On some points of difference between the English system of law and that prevailing on the Continent regarding negotiable securities" *Journal of the Institute of Bankers* 1 (1880) 430; FR Malan *Collective Securities Depositories and the Transfer of Securities* (1984) 7-11; and JL Yeats, R de la Harpe, R Jooste, H Stoop, R Cassim, J Seligmann, L Kent, R Bradstreet, RC Williams, MF Cassim, E Swanepoel, FHI Cassim & K Jarvis (2018) *Commentary on the Companies Act of 2008* 2-811.

Since 31 December 2015, the *Aktienrechtsnovelle* 2016 (BGBl. v. 22.12.2015, 2565). has been in force, and under which the issue of bearer shares may only occur in limited instances (see § 26h, *Einführungsgesetz zum Aktiengesetz*). Thus there has been a shift toward a registered securities dispensation, at least for equities.

52 See also Chapter 3, § 3 1and Chapter 4, § 4 1, for an analysis of the harmonisation of the received (English) common law securities law concepts with more Civilian character of the underlying South African private law.

53 Or, later in the case of uncertificated securities, *both* in the form of the electronic register entry.

54 Michie *The Global Securities Market* 137.

consequences of this divergence are important to understanding the development of securities markets and the role of debt securities within them. This is best illustrated by the contrast between England and Germany.

First, there is significant divergence in terms of the roles of banks. In Germany, government oversight in the financial sector remained strong. Within this regulated environment, banks began to take on greater responsibilities in the securities markets. An influential factor in this development is the legal nature of German securities. From the 19th century onward, German law treated most securities as negotiable instruments (as a species of "*wertpapier*"), allowing banks to take true deposit of securities for their clients. As a true depositary of securities, the role of banks in the securities industry grew, taking on an increasingly central function as transactional intermediaries in the purchase, sale and holding of securities. German banks (characterised as *unitary* for allowing commercial *and* investment banking activities within a single banking entity, as well as for their high degree of operational centralisation) were able to become members of stock exchanges, and later played a decisive role in the immobilisation process.[55]

In England, due to the use of registered securities, the transfer and holding of securities was facilitated by *issuers* through their own (or their agents') securities registers, and the overall regulatory regime remained one of private enforcement. This entrenched a stricter division of functions between the broker-jobber-exchange complex and the banking sector – it was neither necessary nor permitted for banks to become members of the English securities exchanges.[56]

As a result, the activities of a number of German banking institutions included not only traditional banking operations, but stretched across the entire spectrum of financial services, including the promotion, deposit, and trading of securities. This remains the case in Germany today.[57] In contrast, the result in England was that banks clustered in London to foster special relations with brokers and other intermediaries, reducing their transaction costs as *clients* rather than functionaries within the securities industry. This produced the heavily specialised branches of the securities industry familiar to the Anglo-American market today, including the division between investment banks, stockbrokers and commercial banks.[58] Until very recently, South Africa followed this latter trend, though today

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55 Micheler (2007) *LQR* 274-276. See also Chapter 3, § 3 2 1 1.

56 Michie *The Global Securities Market* 137 and 139, and, generally, further also Y Cassis, GD Feldman & U Olsson (eds) *The Evolution of Financial Institutions and Markets in Twentieth Century Europe* (1995) 84–85 & 187–90; M Bordo & R Sylla (eds) *Anglo-American Financial System: Institutions and Markets in the Twentieth Century* (1995) 395-400; Y Cassis (ed) *Finance and Financiers in European History, 1880–1960* (1992), 68 & 72–3; as cited therein.

57 See Chapter 3, § 3 2 1 1.

58 Michie *The Global Securities Market* 137 and 139, and, generally, further also Y Cassis, GD Feldman & U Olsson (eds) *The Evolution of Financial Institutions and Markets in Twentieth Century Europe* (1995) 84–85 & 187–90; M Bordo & R Sylla (eds) *Anglo-American Financial System: Institutions and Markets in the Twentieth Century* (1995) 395-400; Y Cassis (ed) *Finance and Financiers in European History, 1880–1960* (1992), 68 & 72–3; as cited therein.

many of its largest banks pursue an "integrated financial services" strategy, offering transactional, lending, investment and insurance products and services across the retail, commercial *and* investment banking sectors.

Second, as shown below, the different operational structures of German and British banks also influenced the manner in which debt securities were utilised by banks, causing a divergence in the demand and the market size for these instruments. Pre-20th century securities markets were small and homogeneous, and traditional banking greatly overshadowed securities in the overall capital market. In these earlier capital markets (before securities' meteoric rise to financial centrality began to emerge in the late 19th century) fixed-income securities, due to their liquidity and government-backed stability, served a different purpose. Just as equity securities were primarily used by a few elite capitalists to gain and entrench access to a finite number of lucrative projects, in this earlier financial era debt securities were mainly employed by the banking sector as a temporary locus for idle capital balances.

As a means of investment, debt securities in the 18th and 19th centuries had some long-term investors, but their prime function at the time was far more short-term. Banks' trade credit would typically be tied up in their clients' trading stock, making it illiquid. Yet savings depositors and users of credit facilities needed their money to be accessible at will, meaning banks were required to maintain a large buffer of idle funds so as to be able to handle fluctuation in withdrawals. This informs the mitigation of so-called "funding liquidity risk".[59]

Due to the ease with which debt securities could be bought, sold, or even leveraged (through increasingly advanced trading techniques at these exchanges) over the short run, merchants and banks found that employing these balances in securities markets provided a profitable short-run return at little risk. Securities markets were already highly liquid, which guaranteed quick and easy access to those funds if and when required. In this way the securities markets' primary function at this time was short-term idle fund deployment, rather than portfolio gains through medium- and long-term investment. In this way debt securities were most important to the *money market*, easing the credit supply, lowering interest rates and stabilising the banking system.[60] The practice has remained an important function of the bond market to this day, although no longer its only function.

However, specific responses to funding liquidity risk (and maintaining the capital required by fractional reserve rates) were not transnationally uniform. Both the scope of this problem and the

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59 P Hawkins & C Torr "Banks" in K Van Wyk, Z Botha & I Goodspeed *Understanding South African Financial Markets* 5 ed (2015) 69.

60 Michie *The Global Securities Market* 44-48, 55, 57, 58-59; and D Hancock *Citizens of the World: London Merchants and the Integration of the British Atlantic Community 1735–1785* (1995) 258–72.

type of solution adopted was largely determined by the operational character of the banking system in place.

Countries with unitary banking systems allow both commercial and investment banking operations to be housed in a single bank (examples include Germany or early USA). The diverse operations of unitary banks are centrally managed, both vertically and horizontally more integrated, and quite simply bigger. Consequently, within the more centralised structure of these banks, the issue of internally balancing illiquid longer-term trade credit with the demand for overdraft facilities and consumer deposit withdrawals is more complex. Yet scope cuts both ways, and within these banks there is a larger amount of funds available (specifically in the investment banking component). Therefore, to curb funding liquidity risk, a greater amount of non-depository capital is held in securities markets by the banks' investment arms.[61] During the 18th and 19th century this came to define the role of securities in countries with unitary banking systems. The portfolio positions held by the banking sector in the securities market moved in step to the supply and demand for withdrawals and deposits. This increased the demand for debt securities, contributed to a faster turnover in securities markets, and greatly stabilised the money markets.

In contrast are countries (for example Britain and, by extension, South Africa) where commercial and investment banking activities were conducted by separate entities, or at least where Chinese walls within a banking group structure were maintained more strictly. As a point of departure these banks operated without the benefits of an investment banking component, and are also unable to place idle balances in securities markets without the use of an intermediary service provider such as a broker. Further, these banks use a more localised, essentially modular, "branch-banking" system, with each subordinate branch operating more autonomously, self-sufficiently, and carrying more responsibility for keeping its own deposits and loans balanced. Historically, therefore, this greatly reduced the complexity of balancing the bank's overall deposits and loans (as well as maintaining the fractional reserve rate), as branches remained to a degree insulated from one another, and the bank more insulated from the failure of individual branches. With funding liquidity risk spread in this manner, it lessened the need for a large (centralised) fund of idle capital, dampening the demand for fixed-income debt securities in which to employ it.[62]

The result is a historically lower overall demand for debt securities in countries with this kind of system. In 18th and 19th century England most debt securities were taken up by the English public and foreign investors, and held, and periodically restructured by quasi-public institutions such as the

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[61] Michie *The Global Securities Market* 137 and 139, and, generally, further also Y Cassis, GD Feldman & U Olsson (eds) *The Evolution of Financial Institutions and Markets in Twentieth Century Europe* (1995) 84–85 & 187–90; M Bordo & R Sylla (eds) *Anglo-American Financial System: Institutions and Markets in the Twentieth Century* (1995) 395-400; Y Cassis (ed) *Finance and Financiers in European History, 1880–1960* (1992), 68 & 72–3; as cited therein.

[62] Michie *The Global Securities Market* 125-128.

Bank of England to improve government liquidity. This also partially explains the uniquely marginal role of debt instruments in the early South African capital market, where branch-banking, equity and an abundance of gold adequately met the needs of its early capitalists and government.[63] Over time this has changed, but these now seemingly anachronistic features of the South African banking environment had a marked influence on the market's composition and dynamics, and therefore on its development.

2 2 3 The character of English securities regulation

The English approach to securities regulation is largely characterised by private enforcement, with an emphasis on intra-industry oversight, and with minimal interference from the executive government (and to a lesser degree from the legislature). These features are also a product of a number of historical factors, and the role of government in the regulation of securities and securities markets is thus limited. An analogous position exists in the field of corporate governance. Here (1) South Africa has also been subjected to comparably strong English influence,[64] and (2) most of the regulatory substance lies beyond the black letter law, yet in limited instances can be co-opted into the black letter law via legal rules which have explicit and *open-ended* normative policy content. This, in limited instances, has allowed such so-called "soft law" principles to become directly actionable as elements of a formal cause of action.[65] Again this trend appears today to be steadily reversing, but that does not impact the analysis undertaken here.

The post-Cromwellian parliamentary dispensation in England effected a lasting political and economic stability not necessarily exhibited by its then contemporary Continental neighbours. As a consequence, England's debts (at last sufficiently distinct from the unpredictable, default-prone nobles' and monarchs' more feudal debts that preceded them) were perceived as inherently less risk-prone, and more reliable.[66] This led to a broadening and deepening of English securities markets

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63 South Africa's rich gold resources made the state far less reliant on debt finance – see § 2 3 2, at 48-49.

64 S Andreasson "Understanding corporate governance reform in South Africa: anglo-american divergence, the King Reports, and hybridization" (2011) 50(4) *Business & Society* 654.

This view is also supported in Yeats et al *Commentary 2008* "Introduction to and overview of Part E of Chapter 2" (2-506 *et seq*) in n 440, as "[h]istorically, exchanges have been regarded as self-regulating organisations because they had a wide degree of autonomy over their rules and had to monitor and enforce their own rules."

65 A good example would be the delictual element of wrongfulness in cases of omission or pure economic loss – for example M Loubser & R Midgley (eds) *The Law of Delict in South Africa* (2010) 224-230 and FDJ Brand "Aspects of wrongfulness: a series of lectures" (2014) 25(3) *Stellenbosch Law Review* 451 in conjunction with "Reflections on wrongfulness in the law of delict" (2007) 124(1) *South African Law Journal* 76.

For a related and invaluable example in the context of corporate governance, as well as for a generally useful discussion on the interrelation of the law and private enforcement in that context, see for instance *Minister of Water Affairs & Forestry v Stilfontein Gold Mining Company & Others* 2006 (5) SA 333 (W).

66 Baskin & Miranti *A History of Corporate Finance* 102-103.

as it attracted a greater multitude of risk-averse investors, who found the new levels of risk in the market more acceptable than the less stable European environment.

Unfortunately, this early market growth occurred whilst a proper understanding of securities markets had not yet fully developed. Growth from capital inflows continued into the 18th century, finally resulting in an over-expansion leading up to 1720. At this stage, the actions of an overly-sanguine market, ambitious financial institutions, and a *laissez-faire* government approach caused what is commonly referred to as the "South Sea Bubble". It must be noted here that the number of shares trading on the London market before the South Sea-driven collapse of the market was, relative to historical levels, high. This should not be seen as an indication of the overall debt-equity configuration of securities markets of this era, as debt securities remained by far the most prevalent.[67]

In response to what was correctly identified as an unsustainably overheated financial sector, Parliament legislated the Bubble Act of 1720. It was a poor solution. The Act operated to make new incorporation very difficult, and allowed the prosecution of companies using old, "shelf" charters whose company purposes did not match the character of actual operations.[68] Ironically, the Act was rarely enforced during its operative lifetime.[69] Ultimately, the effect was a century-long securities and company-formation slump.[70] At the heart of the problem was a combination of three interdependent causes leading cumulatively to the modern English market's first failure. First, there existed an overly-cosy and naïve financial relationship between big business and government.[71] Second, large-scale informational defects in the market caused ruthless and widespread price-manipulation and fraud.[72] Third, unscrupulous traders played a large part in fuelling the fire of speculation, to the investing public's detriment.[73] The Bubble Act addressed none of this.

Other early legislative interventions around the turn of the 18th century also attempted to put in place rudimentary but more lasting market safeguards. For example, jobbers and brokers had to sign oaths to avoid conflicts of interest, practice their trade "fairly and honestly", as well as obtain proper licencing; there was also the establishment and appointment of an oversight committee by prominent

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67 See Baskin (1997) *Bus Hist Rev* 206 n 14.

68 Gower *Modern Company Law* 27 – for example, the stated purpose of the charter of the Sword Blade "bank" was, obviously, to manufacture sword blades.

69 Gower *Modern Company Law* 28 & 30.

70 See Michie *The Global Securities Market* 31-47 and Baskin & Miranti *A History of Corporate Finance* 99-113, for an in-depth discussion of the causes, details and consequences of this infamous market disruption.

71 Abundantly evident in the manner in which the South Sea Company, the Bank of England, and government co-operated to consolidate, restructure, and further commoditise the national debt.

72 Baskin & Miranti *A History of Corporate Finance* 117.

73 Shannon *Economic History* (1931) 268, n 3; and Williston (1888) *Harvard L Rev* 111.

public functionaries of London.[74] Following the failure of the York Buildings company – one of the only companies to have survived the South Sea Bubble crash[75] – in 1734, the government outlawed options trading, but via a loophole comparable margin-based trading slipped by unsanctioned. These seem to be the only examples of overt government intervention into securities trading practices.

The primary insight from statutory measures such as these (and indeed the Bubble Act itself) seems to be that the activities of the securities industry were *in principle* approved of by Parliament,[76] but not well understood. The effect of these types of laws – ostensibly to rid the market of abusive practices – was slight, coupled with unintended consequences that were often evidently detrimental. Additionally, the strict institutionally entrenched compartmentalisation of the various role-players in securities markets of today were virtually non-existent. The impression is that the government of the time had neither the understanding, capacity nor willingness to make the necessary changes to its corporate and financial law, or to call into being a regulatory agency with the powers necessary to curb abuses effectively in the market.

From this point forward, it becomes clear that the English government took what seems to have been a strongly anti-interventionist position. This left the market's stability in the hands of the private sector. In reality the relationship between the wealthy business elite and the British government was never quite at arms-length. Thus, while regulation was officially eschewed by policy-makers, indirect and informal channels of oversight within the inner-circles of the upper class remained. Nonetheless the market was, in principle, left mainly to its own devices.[77] In sum, the English government's view at the time seems to have been that it lacked the capacity and ability to actively regulate securities markets, and continued to allow this function to be fulfilled through alignment of private and public interests in a more informal way.[78]

By the 1770s the market for debt and even select companies' equity was recovering. Over time, as default-risk began steadily to abate, trade in select state debt instruments, as well as the equities of the Bank of England, the East India Company and a few others began to reinvigorate the English securities market.[79] Policy thinking shifted even further towards benign apathy on the part of government. The relatively safe debt securities and a small number of quasi-public monopolies' equity dominated the securities market. This strengthened the view that informally supervised self-

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74 Baskin & Miranti *A History of Corporate Finance* 118-119 – in keeping with the era, of course, these rules functioned more to exclude persons on a social or class basis than a reputational or substantive one.

75 Williston (1888) *Harvard L Rev* 112 – aside from the trading companies and Bank of England, only two assurance companies, the English Copper Company and the York Buildings Society company survived.

76 Evans (1908) 8(5) *Columbia L Rev* 351.

77 Baskin & Miranti *A History of Corporate Finance* 117 & 119.

78 Baskin & Miranti *A History of Corporate Finance* 119, 117 & 123.

79 Michie *The Global Securities Market* 42.

regulation, from a cost-benefit perspective, was a better trade-off than official oversight. Market players were largely left to determine the rules of play via private enforcement at and amongst the exchanges.[80] The market was given a freedom that allowed it to pursue the further sophistication of its practices and techniques virtually unencumbered.[81] Strong, adaptable markets resulted from this policy approach, and the regulatory cost-benefit analysis of the time appears, with the benefit of hindsight, to have been correct.[82]

From the crisis of 1720 to the mid-19th century, government's attitude toward the economy, corporate affairs, and securities markets had also undergone a more general structural change. Much of this is still evident today. The number of "companies" – in the more modern sense – had increased dramatically, and the scale and scope of activities had greatly diversified. Mercantilist thinking, which perceived the corporate form as an instrument or agent of national geographic objectives, was on the wane; conversely, liberalism and a *laissez-faire* approach to commercial activity (riding largely on the wave of the Industrial Revolution) was on the wax.[83]

The British securities market was becoming increasingly refined and efficient, free from government intervention. The one area in which the British government did exert considerable influence was in setting standards for financial reporting and disclosures by companies, which still remains a core component of securities regulation today. As the capital-intensive economic expansion raged on, the need for higher quality *information* began to grow. The government responded by implementing standards for the railroad, gas and electricity industries in 1868, 1871 and 1882 respectively.[84] Finally, the Companies Act of 1900[85] mandated that all registered companies have auditor-approved statements, and the substantive shortcomings within the reporting standards themselves were all but remedied by 1929.[86]

In this way it was the rapidly progressing company law legislation of the 19th century that took up the mantle of regulating the risk inherent in securities, and did so mainly through financial reporting and disclosure. Nevertheless, improved disclosure had limited effect – market imperfections, risk, and informational bias continued to support the preference for debt securities until well into the 20th century, including in the ever expanding railroad and canal ("public infrastructure") sector.[87] It is

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80 Baskin & Miranti *A History of Corporate Finance* 119; Michie *The Global Securities Market* 54-55.

81 Michie *The Global Securities Market* 42.

82 Baskin & Miranti *A History of Corporate Finance* 119.

83 Baskin & Miranti *A History of Corporate Finance* 161.

84 Baskin & Miranti *A History of Corporate Finance* 185.

85 63 & 64 Vict. c 48.

86 Baskin & Miranti *A History of Corporate Finance* 184; remedies in the disclosure provisions of the Companies Act of 1928, 19 & 20, Geo. 5, c 23.

87 Baskin & Miranti *A History of Corporate Finance* 145.

almost unnecessary to note that the attainment of limited liability for incorporated entities during the latter half of the 19th century also greatly impacted the financial markets through increasing the ability of corporations' to leverage their capital, and increasing the number of entities which could do so.

By the end of the 19th century and beginning of the 20th, a more important structural fissure in securities regulation emerged – between the UK and the United States (by this time a major equities market). Unsurprisingly, it was the result of another – arguably the greatest – market disruption: the Great Crash of 1929. The speculative bubble in equity holdings that had steadily been building during the early 20th century finally burst in 1929, triggering a massive US market collapse and lasting subsequent economic depression which spread across the globe.

In response to the crash, the US federal government fundamentally changed the way their securities markets were regulated. Federal securities legislation was put in place – the Securities Act of 1933 and the Securities Exchange Act of 1934[88] – establishing a tripartite system of oversight between the Securities Exchange Commission (founded for this very purpose under the executive branch of government), Congress, and various branches of professionals in the securities industry. By putting the executive and legislative tiers of government close to the centre of its securities regulation, the federal government had made active engagement with administrative law a key aspect of securities law. There is no doubt these measures increased safeguards and addressed key areas of risk in the market. However, from an economic standpoint, they had also increased monitoring costs, raised the cost and complexity of compliance, and created a number of barriers to entry and exit, which limited the efficiency of their markets.[89]

These measures had a lasting influence on the global approach to how the securities industry should be regulated, despite the fact that few jurisdictions directly adopted this model. Most importantly, the US authorities identified that the ties between companies and their shareholders, as well as the division of responsibilities and duties between the various agency or other relationships in the securities trade are crucial to its stability.[90] In so doing, they strongly endorsed the theoretical view of the firm (and markets) developed by A Berle and G Means in their *The Modern Corporation and Private Property*.[91] The Glass-Steagall Act[92] also, until its effective repeal in 1999, definitively uncoupled the investment banking sector operating in the securities markets from its commercial banking counterpart, leading the US away from a more unitary style of banking.

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88 48 Stat. 74, codified from 15 U.S.C. § 77 and 48 Stat. 881, codified from 15 U.S.C. § 78 respectively.

89 Baskin & Miranti *A History of Corporate Finance* 202 & 207.

90 Baskin & Miranti *A History of Corporate Finance* 201-202.

91 A Berle & G Means *The Modern Corporation and Private Property* (1932) – as discussed in Baskin & Miranti *A History of Corporate Finance* 200.

92 1933 (48 Stat. 162).

In contrast, during the first third of the 20th century the British shared neither the economic growth nor consequent fever of equities speculation experienced in the US – war debt, currency issues, greater conservatism regarding equity securities, and other factors allowed them to avoid a comparable speculation-driven share bubble. When the Crash and the resulting Depression spilled over into the international market, Britain was not affected as severely. Furthermore, whereas the United States pioneered the shift towards increasingly widely-held shareholding and a more entrenched and pronounced separation between shareholders and managers (so-called managerial capitalism), the UK did not follow suit and British capital (and wealth) continued to stay more private.[93] As a result, the contagion in financial markets had a less dramatic effect on the overall British economy.

As in the past, Britain did not involve the legislature or the executive government in market regulation to any significant extent. Until quite recently, it continued on much the same path as before – private enforcement, "trusted-peer'" monitoring, stringent financial reporting standards, and professional associations.[94]

2 3 A history of the South African securities market

As should already be clear, the character of the South African securities market, its instruments, and its regulation is well described as inherited.

The emergence and development of modern securities and their marketplace remained a phenomenon contained within Europe and the British Isles until these markets were (1) sufficiently distinguished from the rest of the financial industry, and (2) adequately advanced to have begun contributing meaningfully to the overall economies of their respective countries. Thereafter, around the mid-19th century, securities began to spread elsewhere, and reached South Africa.

The discovery of South Africa's rich mineral resources in the mid-to-late 1800s coincided with this global expansion of securities markets beyond Europe.[95] The capital intensive nature of mining activities as well as the aptly speculative nature of prospecting itself proved a perfect match for financing by means of securities. The environment was particularly well suited for equities. Moreover, as South Africa was at that time under British control, the methodology (i.e. techniques, practices, and commercial as well as legal approach) used to implement these corporate financing techniques

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93 Baskin & Miranti *A History of Corporate Finance* 209.

94 Baskin & Miranti *A History of Corporate Finance* 208 & 209.

95 Michie *The Global Securities Market* 111.

was principally influenced by that of England. In this union of securities, mining, and essentially English principles lies the origin of the securities market in South Africa, as well as an explanation of many aspects of the past and present regulatory landscape in the country.

2 3 1 The early years

In 18th century Europe and England there were still relatively few incorporated public companies (mostly universities, utilities, local governments and quasi-private commercial enterprises), and far fewer still operating in the Cape. Yet there was some local commercial activity of this nature.

The Council of Seventeen issued charters for the Geoctroyeerde Societyt de Mynwerken Aan de Simonsberg in 1743[96] and the Bank van Leening in 1793.[97] A decade later, with the incorporation of the Geoctroyeerde Africaansche Visscherij Societeit,[98] the first opportunity arose for those in the Cape to invest in the stock of a commercial enterprise. Thereafter Cape companies began to grow in number. The Cape of Good Hope Savings Society, the South African Association for the Administration and Settlement of Estates, and the Board of Executors were among the first to come into being via ordinance.[99] With these developments the idea of joint-stock operations and investment became increasingly familiar to the people of the Cape.[100]

Trading in securities was seen locally from the 18th century onwards, taking place in informal marketplaces.[101] This seems to resemble the development of bourses in 17th century Europe,[102] operating as places where traders could meet and conclude a multitude of commercial transactions (including the purchase and sale of commodities, money market instruments, securities and even goods). In 1782, the Stellenbosch *Landdrost* made public a proclamation dealing with the yearly return of the "*Effekten deezer Colonie*". This indicates a negotiable government debt security – an *effekten*[103] – establishing that debt securities were also in use at that time.

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96 E Rosenthal *On 'Change Through the Years* (1968) 15-16.

97 E De la Rey "Aspekte van die vroeë maatskappyereg: 'n vergelykende oorsig" (1986) *Codicillus* 4 8.

98 De La Rey (1986) *Codicillus* 8 – a Dutch company established mainly for the purposes of whaling and seal-hunting.

99 "*Omstreeks* [1834] *word daar verskeie ordonnansies in verband met spesifieke maatskappye aan die Kaap aanvaar.*" – De Lay Rey (1986) *Codicillus* 10.

100 De Lay Rey (1986) *Codicillus* 8-11.

101 M Lukasiewicz *Reinvestigating Southern African stock markets: the making of the Johannesburg Stock Exchange. 1880-1889* – unpublished paper presented at the 8th New Frontiers in African Economic History Workshop hosted in Lund, 6-7 December 2013 (copy on file with the author) 5.

102 Named after Antwerp's original trading location, the Place de la Bourse, a term which steadily became the accepted term for securities exchanges the world over – see Michie *The Global Securities Market* 22.

103 The Afrikaans for government bonds is *staatseffekte*.

Such trading was formalised in 1817 with the establishment of the Cape Town Commercial Exchange, but the exchange retained the multidimensional character of an informal marketplace.[104] At the Exchange, securities included both debt and equity. In addition to stock available in a small number of incorporated enterprises, the Colonial Treasury's debentures (or rather *effecten*) were also found at the marketplace.[105]

As the practice of discounting became better understood debt instruments came to be seen as ideal interim investments for idle capital[106] and, together with the rise of equity instruments, the securities-component of this marketplace gradually acquired a character of its own. This mirrors earlier English developments.[107]

By the 1850s, individuals dealing in securities had spread all over the Cape colony (a far larger area than the Western Cape or its predecessor the Cape province), yet equity securities gradually grew to become more popular than debt instruments.[108] Limited liability reached the Cape at the start of the 1860s, with other areas of today's South Africa following suit before 1900.[109] A wave of new incorporations (freed from the need for legislative intervention to obtain charters) resulted,[110] increasing the predominance of equity. This has remained a definitive feature of the South African securities market. Even as late as 1914 government debt instruments totalled only 1,2% of the total national assets of the then Union of South Africa.[111]

However, debt securities did not fall into disuse. In what was then known as the Transvaal area, there is notable evidence that debt securities remained a fixture of the securities market. One of the provisions found in the Articles of Association of the Netherlands Afrikaans Company (formed to promote the South African Republic in various ways), reads:[112]

> "The Company is forbidden to speculate in securities or Bills of Exchange, or to *lend* money without security *to public authorities* or to individuals, and is obliged to invest all available money effectively and safely."

This could suggest the Company was prevented, inter alia, from subscribing to any unsecured debt instruments issued in the public sphere. Further, it is recorded that the infamous Drift Crisis of the

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104 Rosenthal *On 'Change* 21-22.

105 Rosenthal *On 'Change* 22.

106 Michie *The Global Securities Market* 22-23; and § 2 2 2 above.

107 See above at § 2 1 and § 2 2 2.

108 Rosenthal *On 'Change* 28-35.

109 See Chapter 3 – § 3 1.

110 See for example, Rosenthal *On 'Change* 36 & 37.

111 See § 2 3 2 below.

112 Rosenthal *On 'Change* 41-42 [own emphasis].

mid-1890s not only affected the price of gilt-edged “Chartered” shares (reacting to the possibility of a South African Federation), but also caused an additional subscription to be issued seeing as “interest on the Matabele War debentures would fall due at the New Year”.[113] Clearly public authorities (such as municipalities and governments) were making use of debt instruments to finance expenditures, including armed conflict.

Similar observations can be made in the field of commercial debt securities. In 1895 the Cape legislated an act entitled the Company Debenture Act 43 of 1895,[114] the stated purpose of which was “[t]o Provide for Creation and Registration of Preferential Debentures in certain cases by Registered Companies acting under the authority of Acts of Parliament”.[115] Furthermore, funding for the Witwatersrand Club and Exchange Company (founded by Cecil John Rhodes, and the precursor to the JSE) was obtained by issuing a prospectus in 1887 offering a total of 3 500 £1 debentures, although the offer for subscription ultimately failed for lack of interest.[116]

It would appear to be certain that the use of debt securities in the commercial sphere was not unknown to the businessmen of South Africa during the 19th century. By 1926, one authority states that:[117]

> “[t]he most usual form of borrowing by a company is on debentures.”

Overall, a picture begins to emerge of these early domestic markets in which debt securities played a significant, although secondary, role. The state of the law also supports this conclusion. Developments such as publicity requirements (via proclamation) regarding government debt securities,[118] as well as the promulgation of legislation dealing with company debentures, show that debt instruments were important enough to merit direct legal attention.

Despite this it was equity, trading within and outside exchange centres, that dominated the market. Why? The answer lies in the forces driving the development of formal securities markets, the capital-intensive nature of industries at the forefront of early corporate finance by means of securities, the means by which government financed its expenditures, and the objectives of early investors in the secondary market.

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113 Rosenthal *On ‘Change* 185-186.

114 De Lay Rey (1986) *Codicillus* 14. This Act is discussed at length in Chapter 3, § 3 1.

115 The Act’s Long Title.

116 Lukasiewicz *Reinvestigating South African stock markets* 20.

117 LOP Pyemont *Company Law of South Africa* (1926) at 204.

118 Rosenthal *On ‘Change* 17.

The establishment of a formal, institutional securities market occurred towards the end of the 19th century, driven exclusively by securities in the mining industry, and its concomitant need for large scale (railway) transport infrastructure. What differentiated these mining-oriented exchanges from their predecessors was an exclusive focus on securities only, and equities specifically, allowing them to transition from commercial exchanges to *securities* exchanges. Specialist mining exchanges sprung up around mineral discoveries across the country.[119] Moreover, via mining and railways, South Africa gained access to the progress and resources of the international capital market.[120]

The modernisation of the South African securities industry and the emergence of a modern-looking *securities* exchange[121] started with diamonds in Kimberly in the early 1880s. The Kimberley Royal Stock Exchange, successor to a short-lived predecessor,[122] is seen as the first structured, prolonged instance of securities (read: shares) trading in the country.[123] Others followed, including exchanges in Klerksdorp, Potchefstroom, Pietermaritzburg, Durban and Cape Town. Yet the latter group's mix of trading shares, mining claims, goods, or even bills of exchange serve as evidence of their more prototypical nature,[124] more closely resembling the Cape Town Commercial Exchange than a true securities exchange.

The discovery of gold followed the same pattern, and exchanges proliferated.[125] Ultimately the Witwatersrand, as the epicentre of the gold mining boom, became the epicentre of securities trading. In 1888, a year after its inception on 8 November 1887,[126] the "Exchange and Chambers Company" counted 600 members, and by the end of its second year had virtually no rivals.[127] It would later be known as the Johannesburg Stock Exchange. However, the output of the mining firms during the 1880s did not justify the volume of capital they were attracting.[128] It appears bullish sentiment in London,[129] rather than underlying value, was the ultimate impetus for a modern securities market

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119 Michie *The Global Securities Market* 100.

120 Lukasiewicz *Reinvestigating South African stock markets* 5.

121 I.e. the JSE.

122 Rosenthal *On 'Change* 58-61, and Lukasiewicz *Reinvestigating South African stock markets* 9. The Kimberly Share Exchange, Broking, and General Agency Company Limited was established in 1880. Its trade was not limited to the equity securities of mining or banking firms, and included *inter alia* "the purchase and sale of claims or other properties." Whether or not "claims" signified debt securities such as debentures is not clear, but in all likelihood it does not, denoting mineral rights – as "claims" – instead.

123 Lukasiewicz *Reinvestigating South African stock markets* 5.

124 See Rosenthal *On 'Change* 88-118.

125 Michie *The Global Securities Market* 107.

126 M Bryant *Taking Stock: Johannesburg Stock Exchange – the first 100 years* (1987) 1.

127 Michie *The Global Securities Market* 107-108, Bryant *Taking Stock* 5, and Lukasiewicz *Reinvestigating South African stock markets* 26.

128 Lukasiewicz *Reinvestigating South African stock markets* 8.

129 Fed by periodic speculative upswings such as earlier in 1823-1825 or 1844-1845 – see Michie *The Global Securities Market* 67 and Gower *Modern Company Law* 40 respectively.

infrastructure in South Africa.[130] Before then, for most of the 1880s, South African mining capitalists took recourse to the London capital market for funding, rather than finding it closer to home.[131]

By 1895, the JSE had become the country's premier exchange. A second mining stock boom meant the JSE's market capitalisation stood at £103m in mid-1895.[132] It successfully attracted Johannesburg's brokers;[133] strategically aligned itself with a vast international network of mining exchanges essentially all trading the same shares; dominated its rivals not only in the north but also in the Cape; and had even begun listing non-mining companies on its board.[134] In 1897, South African Breweries listed on the JSE – the first non-mining company to do so, and the only such company until 1910.[135] Importantly, as the JSE started upon its own internal processes of refinement, the first set of "rules" for the listing of companies emerged late in 1889 – yet within them no mention is made of debt securities.[136]

In Britain, it is clear that the amount of securities *in overall circulation* exceeded the amount of securities traded on exchange platforms.[137] The same can be said of South Africa's securities market,[138] and although not traded on the JSE, *securities at large* certainly included debt instruments (public, quasi-public and commercial).

The South African securities environment remained unstable and largely speculative throughout the late 19th and early 20th century.[139] The first "boom" on the JSE occurred between 1888 and 1889, and was essentially driven by demand-side hubris, with little or no relation to the underlying value of securities or their issuers. It was, predictably, followed by a slump.[140] Margin trading, manipulation of information, and large-scale unchecked speculation caused a high degree of volatility, with large gains and losses. Some of the economic damage caused by the price-amplitudes of these completely unregulated markets was, however, curbed by universal adoption of limited liability

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130 Michie *The Global Securities Market* 106-108, Lukasiewicz *Reinvestigating South African stock markets* 8.

131 Lukasiewicz *Reinvestigating South African stock markets* 5-17.

132 Bryant *Taking Stock* 22

133 Lukasiewicz *Reinvestigating South African stock markets* 21.

134 Michie *The Global Securities Market* 107-108.

135 JSE "Company Overview - History" *JSE* < https://www.jse.co.za/about/history-company-overview > (accessed 20-02-2015).

136 See Lukasiewicz *Reinvestigating South African stock markets* 24, citing the "Minutes of An Ordinary Meeting of the Committee" of the JSE on 12 November 1889.

137 Lukasiewicz *Reinvestigating South African stock markets* 13.

138 A later example of this kind of extra-exchange trading (albeit slightly more formalised) is a "Mr MacNamara's Open Call Exchange" located adjacent to the JSE's building in Commissioner street, which operated from 1907 until the Great War – Rosenthal *On 'Change* 214-215.

139 Lukasiewicz *Reinvestigating South African stock markets* 18-20.

140 Bryant *Taking Stock* 21.

legislation between 1861 and 1892.[141] Freely available limited liability had the effect of insulating investors and businessmen from the full impact of losses through their companies.

It is this volatility of equity market prices which ultimately accounts for the lack of trade in debt securities, and their absence on exchanges. Increased price volatility implies increased scalability of gains, but also of losses. In the wildly speculative, immature, and overly-optimistic South African securities markets of the late 19th century it made no sense to trade in debt-based instruments, as they are specifically used to immunise portfolios to heavily cyclical movements and risk. The collective cognisance of local investors had no memory of ruinous financial events such as those experienced by Europe and Britain in the long-term development of securities markets, and also had no historically entrenched preference for debt.[142]

Nonetheless, what is vital is that by 1900 South Africa had begun to develop, on the back of the international expansion of securities, a market infrastructure of its own, and assimilated rather quickly most of the advances that had taken Britain and Europe hundreds of years to achieve. With this came debentures as a form of corporate borrowing. Government appears also to have co-opted debt securities into their borrowing patterns even earlier.

Yet, the secondary market for debt securities remained obscure and small. This is mainly due to money market conditions[143] and the frenzied pursuance of the scalable gains characteristic of equities. Thus while certainly not absent from South Africa, debt was not actively traded. This remained the case until local and global monetary and other macroeconomic policy shifts of the 1970s and 1980s caused trading in debt securities to become as attractive as holding them.

2 3 2 *Securities in the 20th century*

A few figures speak volumes about the state of local securities markets in the 20th century. In the 1912-1914 period, securities made up 17,6% of South Africa's national assets – of that amount commercial equity securities stood at 16,4%, commercial bonds at 0%, and government bonds totalled 1,2%. The same figures for 1927-1930 were 12%, 0%, and 7,3% respectively, totalling 19,3%; and during 1937-1940, stood at 17,5%, 0%, and 7,2% respectively, and 24,7% in sum.[144]

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141 De Lay Rey (1986) *Codicillus* 4 & 14-15, and JT Pretorius (ed), PA Delport, M Havenga & M Vermaas *Hahlo's Company Law through the Cases* 6 ed (1999) 2; Bryant *Taking Stock* 15.

142 See § 2 1.

143 See § 2 2 2.

144 Michie *The Global Securities Market* 126, 174 & 200 – Table 5.1, 6.2, and 6.3 respectively.

Yet by 1984, holdings in government debt securities (including those of central government, public corporations and local authorities) equalled 50% of the country's GDP.[145]

This shows the overall market as equity-dominated, growing, and one in which the bond and debenture (or rather debt security) component was initially negligibly small.[146] This is largely due to (1) the almost exclusive presence of mining and some infrastructure companies in the securities market of the time; (2) the perceived volatility-profit dynamics seen at the time as the *raison d'être* for exchanges, and (3) branch-banking and the state of the South African money market as mirroring that of England.[147]

Furthermore, during wartime, gold was a crucial global resource. Consequently, the Witwatersrand area had no trouble finding the capital to mine and export it during the conflict of 1914-1918.[148] Thus the Union – rich in gold – had no need to finance its contribution to the Great War through debt, and was in fact experiencing strong capital *inflows*. This must also have been true of funding the other expenditures of the Union. With large reserves of gold and platinum,[149] the government would have had little need to issue bonds and debentures to augment the state's tax-revenue both in and outside of wartime.

Nonetheless, whilst the focus of the Exchange remained the raising of capital through, and speculation in, the shares of mining operations there is evidence that the scope of its activities in terms of "stock" included *inter alia* "municipal and water loans".[150] Thus gilt-edged (government debt) securities had found their way onto the JSE. "Debenture stock" was also likely to have been available on the exchange – denoting a "proprietary interest" in a debenture scheme.[151] By this time, the commercial phrase "stocks and shares" at least had the potential to include, and did include, a few debt securities.[152]

Internationally, securities markets experienced a quantum leap in the first three decades of the 20th century. Global consensus on economic (monetary) policy gravitated towards the gold standard, and

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145 See Final Report of the Commission of Inquiry into the Monetary System and Monetary Policy in South Africa, R.P. 70/1984, Table 3.1.

146 A *caveat* must be attached to the commercial bond figure. It has been noted that according to at least one authority borrowing by companies materially included the use of debentures and so the statistic may be slightly misleading as far as commercial debt securities in circulation is concerned.

147 See § 2 2 2 above.

148 Rosenthal *On 'Change* 227.

149 Rosenthal *On 'Change* 232-233.

150 Rosenthal *On 'Change* 211-212.

151 Pyemont *Company Law* 205 & E Emmet *Pyemont's Company Law of South Africa* 5 ed (1940) 193-194.

152 Here one finds an interesting difference between British and US terminology, where in the former, "stock" denotes any type of security, and the latter only equity – Baskin (1997) *Bus Hist Rev* 207 n 19.

exchange-rate fluctuations disappeared along with consequent currency volatility risk. Currency values converged, so that securities became transnationally tradable and volumes escalated dramatically.[153]The telecommunications revolution vastly reduced temporal gaps between markets, and information flowed seamlessly between financial centres such as Paris, New York, London and Johannesburg. Short-term arbitrage-seeking between these markets became a specialist branch amongst secondary market professionals.[154] In sum, capital mobility (due to the monetary policy of the gold standard era) coupled with near-instant communication and resultant marketability (via the telecommunications revolution) desegregated the world's securities markets on a scale unimaginable in comparison to what preceded it.[155]

However, the long-term effects of the Great Crash of 1929 and other economic and political variables ultimately caused the UK and other Commonwealth members to unpeg their currencies from gold in 1931. South Africa's refusal to follow suit until late in 1932 depressed its economy and securities trade severely. Once it capitulated, however, money flooded back into South Africa at high volumes, the currency value rebounded, confidence returned, and banks regained stability. By mid-1933, the JSE's market capitalisation (still consisting mainly of mining and financial shares) stood at £357m.[156] A period of general domestic stability and prosperity followed,[157] despite a global period of recession.

During the Second World War gold did not have the same priority status as during WWI. However, for South Africa this was offset by a huge expansion of the industrial sector,[158] and a number of significant mining discoveries that upheld the overall strength of the share markets. South Africa experienced little post-War hangover – in fact 1946 was an unparalleled success for the JSE,[159] and by June the JSE's market capitalisation had increased by £1 505m, to total £1 728m.[160]

In 1947, the Union passed the Stock Exchanges Control Act, the first piece of legislation focused on secondary market (exchange) regulation.[161] In 1953, three government bodies (the National Finance Corporation, the SA Reserve Bank and the Public Debt Commission) decided to make use of brokers in matters of government, municipal and parastatal "stocks".[162] The majority of these stocks would

153 Michie *The Global Securities Market* 114.

154 Michie *The Global Securities Market* 112 & 114.

155 Michie *The Global Securities Market* 115.

156 Bryant *Taking Stock* 35.

157 Rosenthal *On 'Change* 239.

158 Bryant *Taking Stock* 52.

159 Rosenthal *On 'Change* 244-245.

160 Bryant *Taking Stock* 51.

161 The Stock Exchanges Control Act 7 of 1947.

162 Bryant *Taking Stock* 65.

have been debt securities – i.e. "gilt-edged securities" or "gilts". This arguably represents the start of an increase in the prominence of debt securities in the domestic market.

The origin of the term "gilt-edged" is thought to come from the first bonds issued by the Bank of England shortly after its formation (which had on the edge of their scripts a golden leaf) and the term gilt-edged securities is the official designation of the bonds of the United Kingdom's government.[163] The market for gilts in South Africa (whether within the JSE or at large) was synonymous with the market for South African government or other public debt securities, which by 1940 already made up at least 7,2% of South African national assets.[164] In 1958, the Treasury issued, for the first time, three-month Treasury Bills – the first local money market *securities*. In response the JSE gave the Treasury its full support in improving the debt sector of the securities market.[165]

The extreme volatility and naiveté that had characterised the earlier securities market had abated by the 1960s, and by the mid-60s another industrial boom was evident.[166] A decade later, the JSE decided to formalise its gilt market. At that stage, the economy and equity markets were depressed,[167] and only a small amount of the gilts in overall circulation were traded within the Exchange.[168] The pervading view of investors and brokers at the time remained that gilts were to be bought when issued, and held until maturity.[169] Then, quite suddenly, the bond market ignited:[170]

> "The rise in turnover from trading on the JSE in gilts – Government, municipal and corporation stocks – is dramatically illustrated by the annual turnovers since 1975. The year-end figure then was R1,3 million. Two years later it had jumped to R20 million and by 1979 it had reached R130,96 million. In 1982 it took off for the stratosphere with R1,27 billion, and in 1985 it notched up to R1,62 billion. *But this is only part of the picture because a good deal of trading in gilts takes place outside the exchange.*"

The reasoning behind the move to a separate gilts trading floor instead of merely continuing with the informal trading of gilts by the few traders who were interested, was the potential of an *active*

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163 M Choudry, G Cross & J Harrison *The Gilt-Edged Market (Securities Institute Operations Management)* (2013) 3 & n 4.

164 See § 2 3 2 above.

165 Bryant *Taking Stock* 72.

166 Rosenthal *On 'Change* 253-254, and Bryant *Taking Stock* 168.

167 The timing is hardly surprising – this occurred just as the global financial economy began to experience its first serious run-in with the impact of inflation, and most likely began to realise the full hedging and arbitrage potential of debt securities.

168 Bryant *Taking Stock* 131.

169 Bryant *Taking Stock* 178.

170 Bryant *Taking Stock* 177 [own emphasis].

secondary market, hence the focus on turnover. More active trading, the reasoning goes, had the potential of adding portfolio value via intensified buyer-seller trading activity.[171]

The macro-economic consequences of the oil price shocks and the collapse of the Bretton-Woods exchange-rate dispensation during the 1970s meant that instruments with locked-in interest rates (primarily bonds and money market securities) became useful tools in active portfolio management, increasing the velocity at which they were traded. Domestically, the South African economy was increasingly isolated by Apartheid-driven sanctions, and the government's budget deficits were steadily ballooning. This bolstered the local bond market, as the state turned to gilt-edged securities to augment its increasingly insufficient tax revenue.

By the end of the decade, there were 764 listed "fixed income securities", just 89 less than listed equity securities.[172] FR Malan notes that:[173]

> "[t]he most important securities dealt in on the Johannesburg Stock Exchange are shares, debentures, and the so-called "gilts", i.e. securities issued by the state, local authorities and public bodies."

The gilts trading floor itself was opened in 1980, and the high prime-rate environment that characterised South Africa in the 1980s guaranteed high trade velocity.[174] By 1982, the JSE's turnover in gilt-edged (state) securities *exceeded* turnover in equities,[175] in line with the sudden explosion of the gilt-market discussed above. In 1983, JSE gilts were trading at a total market volume of R22bn (three times the 1982 nominal amount and around the same as the total market capital of the JSE of 1968), with its own index.[176]

However, the South African market for commercial debt securities was smaller and less active. Although some of these non-sovereign securities had also come to be traded on the JSE, they traded on the equities floor. Between 1984 and 1989, the major companies in South Africa raised their capital at an equity-versus-debt ratio of 9,6:1, and by 1989 listed corporate bonds made up only R2,4bn compared to the JSE's R96bn in gilt securities.[177] The latter also only represented roughly a third of the JSE's total market capitalisation at the time, indicating equities returned to predominance.

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171 Bryant *Taking Stock* 178.

172 Bryant *Taking Stock* 138.

173 Malan *Collective Securities Depositories* 139-140.

174 Bryant *Taking Stock* 143.

175 Malan *Collective Securities Depositories* 140, n 11.

176 Bryant *Taking Stock* 146.

177 PW Davey & C Firer "A South African corporate bond market?" (1992) *Investment Analysts Journal* 41. South African companies are considered comparatively underleveraged – C van Zyl "The Bond Market" in K van Wyk, Z Botha & I Goodspeed *Understanding South African Financial Markets* 5 ed (2015) 346.

Far more importantly, the majority of South African debt securities traded (or were merely held) outside of the formal exchange platform – i.e. "over-the-counter" or "OTC".[178] Outside of the exchange environment, other specialist institutions began to emerge. With the exception of gilts (then gaining significant traction on the JSE)[179] debt securities were held and traded through commercial or merchant banks, institutional investors and other institutions such as building societies and discount houses,[180] as well as the National Finance Corporation;[181] some were also informally traded amongst individuals. By the mid-1980s, most government debt was held by the public sector and financial institutions (excluding commercial, or "monetary" banks, who held far less).[182]

From the 1980s to the turn of the century, the market began to outgrow some of these institutions. For instance, the Deposit-Taking Institutions Act[183] put an end to both building societies and discount houses as *independently operating* financial intermediaries. This also firmly separated deposit-taking institutions from "contractual savings institutions" such as long-term insurers. As a result, banks began to alter their business model, moving from an interest- to a fee-centric approach. This led to reliance on new financial techniques such as asset securitisation and the use of call bonds (redeemable at the behest of the issuer) in order to keep book debts liquid, or move them off-book entirely. Debt securities are, of course, key to the process of securitisation.

During the late 1980s and 1990s, the South African financial markets underwent a period of substantial regulatory reform and institutional change. In 1987, the supervision of banking activities was transferred from the Department of Finance (today the National Treasury) to the South African Reserve Bank.[184] In 1989, following the recommendations of the Stals/Jacobs Report,[185] the Financial Markets Control Act[186] (FMCA) was passed, enabling the creation (through licencing) of formal secondary markets – i.e. exchanges – other than those contemplated in the Stock Exchanges

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178 Davies & Firer (1992) *Investment Analysts Journal* 41 – cf. also PW Davey *Role of Corporate Bonds in South Africa* (1990) (unpublished MBA research report); Commission of Inquiry into the Monetary System and Monetary Policy of South Africa R.P. 70/1984 para 3.21-3.27 (pages 17-18 including Table 3.4).

179 By 1978, the JSE was responsible for more than half of secondary market activity regarding government debt - see R.P. 70/1984, para. 3.22; and generally para. 3.1; as well as § 2 3 1 above.

180 See the (majority) Report of the Stock Exchange Inquiry Commission, R.P. 47/1965 paras 32, 634-638 & 650-655.

181 While it was still in existence. See R.P. 70/1984 para 1.3, and generally Chapter 2 – highlighting Treasury (money market) securities, and where Table 2.1 is particularly useful for a breakdown of Treasury securities holdings; and Chapter 3 for the position on public debt securities, where Table 3.1 is similarly useful.

182 R.P. 70/1984, Table 3.1: for example in 1984 the public sector held R22bn, monetary banks held R4bn, and "other financial institutions (including, presumably, merchant banks) held R20,1bn.

183 94 of 1990.

184 H Falkena, R Bamber, D Llewellyn & T Store, *Financial Regulation in South Africa* (2001) iii.

185 R.P. 70/1984.

186 55 of 1989.

Control Act.[187] This was followed in 1990 by the Financial Services Board Act,[188] which in conjunction with subsequent legislation gave rise to the Financial Services Board. The FSB has emerged as the chief supervisory body for all financial markets in South Africa.

These reforms enabled, in 1989, the formation of the voluntary Bond Market Association, which was at that stage operated as an exchange exempted in terms of the FMCA. In 1996 the Association became annually licenced by the FSB under section 7 of the aforementioned Act, and the Bond Exchange of South Africa (BESA) was born. Together with the JSE (licenced under the Stock Exchanges Control Act) and the South African Futures Exchange ("Safex"; also licenced under the Financial Markets Control Act in 1990), BESA was the third formal exchange operative in modern South Africa. Its members included banks, brokers, certain issuers, and other intermediaries.[189] It should be noted, however, that futures (and forward contracts in general) are not considered securities – thus whilst Safex remained a third exchange, it was not a *securities* exchange.

The Bond Exchange formalised the BMA's (exempted) OTC Bond Market. The vast majority of the JSE's government and commercial debt securities were moved to BESA. Before this the JSE's corporate bonds did not share the separate trading floor for gilts, and those few that were traded at the JSE had traded on the main (equities) floor. The annual turnover of BESA in 1996 amounted to R3 045bn compared to the BMA's R1 821bn in 1994.[190]

In 1999, under this legislative framework, the JSE and four large banks established STRATE, a central securities depository project for the dematerialisation of the JSE's equity securities.[191] Thereafter, listed equities traded in uncertificated form, whilst debt securities at BESA remained certificated. In 2003, BESA's clearing and settlement house (UNEXcor) as well as Central Depository

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187 1 of 1985.

188 97 of 1990.

189 F Viljoen "Settlement of transactions on the South African Bond Exchange" (1998) 10 *SA Mercantile Law Journal* 1 1-4 and C van Zyl "The Bond Market" in C van Zyl, Z Botha, P Skerrit & I Goodspeed (eds) *Understanding South African Financial Markets* 3 ed (2009) 289-290.

190 Bond Exchange of South Africa *Delivery v Payment: Electronic Settlement in the South African Bond Market* (1996) 2; and Viljoen (1998) *SA Merc LJ* 1, 3 & n 3.

191 Yeats et al *Commentary 2008* 2-534 – 2-535, who further remark:

> "Strate is a product of the negotiation between key market players to facilitate the introduction to uncertificated securities and the subsequent merger between the shareholders of Strate, Universal Exchange Corporation (which was a clearing house) and Central Depository Limited (which was a central securities depository for bonds) in 2003. As at 30 May 2016, its shareholders comprised mainly the JSE and financial intuitions: the JSE (44,54%); ABSA Bank Limited (12,67%); FirstRand Bank Limited (12,67%); the Standard Bank of South Africa Limited (14,99%); Nedbank Limited (14,99%) and Citibank NA (0,1%). 423 Many of Strate's shareholders are also Strate-authorised participants, requiring Strate to manage conflicts of interests that arise between the interests of its shareholders and its oversight responsibilities. To try and manage this conflict, Strate has accordingly delegated its enforcement and monitory responsibilities to the Strate Regulator and Supervisory Committee of its board (i.e. controlling body)."

See also Chapter 3, § 3 2 3.

Ltd[192] merged with STRATE Limited, to form Strate Limited.[193] In 2004, the Securities Services Act[194] consolidated the Stock Exchanges Control Act, the FMCA, the Insider Trading Act,[195] and the Custody and Administration of Securities Act.[196] This change was widely perceived as allowing for the dematerialisation of debt securities, and trade at BESA became increasingly uncertificated.

By 2007, BESA was highly ranked internationally both in terms of listings and value – 907 instruments listed at a nominal value of R780bn. Government bonds accounted for 56,43%, parastatals' debt securities 10,29%, financial companies 10,43%, special purpose vehicles 17,97% and "others" 4,88%. Commercial debt securities listed on BESA rose in value from R49bn in 2002 to R208bn by 2006.[197]

Safex and BESA were acquired by the JSE in 2004 and 2009 respectively; thus ending the brief divergence of exchanges occurring after these statutory and regulatory changes. BESA now exists within the JSE as the "Debt Market" or the "Interest Rate Market". Over 50% of the roughly 1 600 listed debt instruments (representing approximately R1,8 trillion in value) originated in the public sphere, and represent around 90% of the liquidity in the market.[198] Nonetheless, corporate debt securities kept increasing in value from R498bn in 2007 to R1 104bn in 2013.[199]

Finally, in terms of the make-up of the market, at present:[200]

> "Strate is the central securities depository for all uncertificated securities listed on the JSE Securities Exchange…Recently Granite Central Securities Depository (Pty) Ltd was granted a conditional licence for bonds and money market instruments, but it remains to be seen whether it will develop into a material role player.
>
> …
>
> The following entities have recently been granted licence to operate the respective exchanges in South Africa: ZAR X (Pty) Ltd to operate a new exchange called 'ZAR X'; 4 Africa Exchange (Pty) Ltd to operate

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192 Which until STRATE (which also replaced the JSE's SASH – South African Settlement House) was the only central securities depository registered in terms of the Custody and Administration of Securities Act.

193 L Swart & VA Lawack-Davids "Understanding South African financial markets: an overview of the regulators" (2010) *Obiter* 619 632.

194 36 of 2004.

195 135 of 1998.

196 38 of 1998 – see Chapter 3, § 3 2 2 below.

197 Van Zyl "The Bond Market" in *Financial Markets* 290-291, and Fig. 10.5 & 10.6.

198 JSE "Debt Market" *JSE* < https://www.jse.co.za/trade/debt-market > (accessed 25-01-2021) [regrettably more recent statistics data are not available on the website].

199 C van Zyl "The Bond Market" in *Understanding South Africa's Financial Markets* 332-334. Again, more recent statistics and data were not found.

200 Yeats et al *Commentary 2008* Int-29, Int-61 & 2-534, and 2-537 for more detail.

> a new ‘4AX’ exchange and A2X Proprietary Limited to operate the ‘A2X’ exchange for ‘cash equities’, but their rules and listings requirements are not covered in these notes as it remains to be seen whether they will become material players.
>
> …
>
> Strate…is affiliated and partnered with various international organisations including the Africa and Middle East Depositories Association and the Americas’ Central Securities Depositories Association. Strate is also a clearing house.”

As has been shown, once debt securities in the more modern sense had developed from their proto-security predecessors, the constitution and operation of more sophisticated securities markets was enabled. This, in turn, allowed markets to find additional uses for debt and equity securities in these markets (as seen most prominently in securities’ collateral and securitisation functions).

Having emerged first on the Continent and thereafter undergoing considerable refinement (especially in England), the colonial era eventually brought these markets and their instruments to South Africa. This accounts for the (predominantly) English influence on the South African securities system and most importantly: (1) its regulatory approach; (2) the manner in which the role and structure of the banking system impacts the domestic development of securities markets; and (3) the legal origins of *registered* securities, which dominate South Africa’s financial system. Finally, along with South Africa’s political advancement into independence and finally legitimate democracy, its securities markets broadened, deepened and grew in sophistication, so that today a large, well-capitalised and efficient domestic market for debt securities is evident.

CHAPTER 3

3 Historic legal developments

Three key themes, all inter-related, are central to this discussion. The first is the marked influence of South African company law on the overall legal position regarding registered securities, and therefore all species of debt securities. This, for reasons which will become clear, is despite the relative unimportance of company debt securities in the marketplace. The second is the profound impact of English law on the South African legal position in these areas. Third is the ascendancy of the "securities concept" as a legal signifier, particularly in the various legislative interventions during the 20th century, culminating in the total dematerialisation of exchange-traded *securities* and the (effective) erasure of the "debenture" concept in the Companies Act of 2008.

3 1 The company security: changes in function and form

From the preceding chapter, it is clear that the volume of debt securities in South Africa has been historically depressed, and further that debt securities originating in the public sphere (such as those issued by government, the Treasury, municipalities or parastatals) have always overshadowed commercial debt securities.[1] Based on this observation, as well as other insights from the preceding general history, this chapter presents a deeper analysis of the concomitant *legal* history of debt securities in South Africa.

All registered securities (whether issued by the state, quasi-public entities or companies) tend to look alike and function in a similar manner, and such differences as there are can be dismissed as largely immaterial. Furthermore, the law regarding company securities appears to have been the most sophisticated, refined and comprehensive (although by no means perfect). Most importantly, the current state of the law regarding securities has largely converged on what has emerged from the law on company securities.[2]

The influence of English law is also central to understanding the development of this area of South African law.[3] After the turn of the 19th century the Cape fell permanently under English control. In so far as there existed at the time a Roman-Dutch law it was kept as the Cape's common law, with the reception of English procedural principles[4] as well as selected substantive law matters.[5] The English influence on substantive law is particularly apparent in the field of commercial law, and specifically company law.[6] The English company law revolution of the 19th century,[7] culminating in the sudden and widespread availability of the incorporated form and limited liability (most notably through the Joint Stock Companies Act of 1856) had a marked impact on the statutory position of South African company law, and also on the proliferation of commercial securities.[8]

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1 Historically, government borrowing was authorised and regulated through a combination of its own prerogative, statute, and delegated legislation; the borrowing of quasi-public entities such as the Treasury or Eskom was traditionally governed by statute – see for example FR Malan *Collective Securities Depositories* (1984) 140-146.

2 This idea will be further developed below in § 3 2, but see also Chapter 4, § 4 1 1.

3 This is due to the marked influence of the English legal and institutional approach to financial markets on the South African financial system, which has already been noted in Chapter 2, § 2 2 and § 2 3 1.

4 See for example PJ Schwikkard & E Van der Merwe *Principles of Evidence* (2012) 1-18 for a helpful account of this development in the law of evidence, or WLR de Vos *Grondslae van die Siviele Prosesreg* LLD thesis Rand Afrikaans University [now University of Johannesburg] (1988) 174 and generally 159-174 for the development of the South African law of civil procedure, and JJ Joubert *Criminal Procedure* 11 ed (2014) 24 for the same regarding criminal procedure.

5 See generally R Zimmerman & D Visser "Introduction – South African Law as a Mixed Legal System" and E Fagan "Roman-Dutch Law in its South African Historical Context" in R Zimmerman & D Visser *Southern Cross: Civil and Common Law in South Africa* (1996) for an excellent exposition of South Africa's civilian and common law mixed legal heritage.

6 E De la Rey "Aspekte van die vroeë maatskappyereg: 'n vergelykende oorsig" (1986) *Codicillus* 4 9.

7 See Chapter 2, notably at § 2 1, § 2 2 & § 2 3 1.

8 JT Pretorius, PA Delport, M Havenga & M Vermaas, *Hahlo's South African Company Law Through the Cases* 6 ed (1999) 1, 2, 5 & 6; and De La Rey (1986) *Codicillus* 4, 9, & 13-14.

Naturally, English company law principles exerted the strongest influence in the Cape,[9] which in turn strongly influenced the other areas.[10] The Colony passed the Joint Stock Companies Limited Liability Act 23 of 1861 on 14 August, essentially an act entirely based on its torch-bearing English counterpart.[11] As in England, the Act was incrementally refined in various iterations. Similar legislative processes were followed in what was then Natal, the Orange Free State and the South African Republic (later the Transvaal Colony) before 1900.[12] The Union of South Africa eventually legislated a national Companies Act in 1926.[13] This process of guided, incremental refinement continued for some time until South African company law broke from its slavish adherence to English law with the Companies Act 61 of 1973, largely due to the efforts of the Van Wyk De Vries Commission.[14]

The Company Debenture Act of 1895 and the Companies Act of 1926 both exhibit an approach to debt securities that is in many respects fundamentally different to the approach initiated by the 1973 Companies regime.[15] This conceptual shift[16] in the legislature's approach is the result of three factors. First is a share-centric development of company law's securities provisions, predicated on the dominance of equity securities in the domestic market. Second is the change in the role of debt and equity instruments from primary market fundraising tools (issuers' tools) to secondary market investment instruments (investors' tools) that occurred over the course of the 20th century.

Third, and most importantly, is the adoption of the term "securities" as a pivotal concept in the statutory framework, reflecting its emergence as a denoting tool for grouping together an extremely complex and increasingly multi-dimensional number of financial instruments. As alluded to in Chapter 1, the term securities is far from the straight-forward catch-all concept it was intended to be. Instead, it appears to evolve over time, and it also functions in a manner that is contextually (and from a statutory point of view) purposively variable. This is the focus of Chapter 6.

The outcome of the inter-related effect of these factors begins to manifest in the Companies Act of 1973 and culminates in the terms adopted by the 2008 Act. Before 1973, the focus of legislation on

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9 De La Rey (1986) *Codicillus* 13. Its counterpart being the Act of 1856.

10 De La Rey (1986) *Codicillus* 4; and Pretorius et al, *Hahlo's Company Law* 2.

11 Pretorius et al, *Hahlo's Company Law* 1-2; and De Lay Rey (1986) *Codicillus* 12.

12 See Pretorius et al, *Hahlo's Company Law* 2; and De La Rey (1986) *Codicillus* 12-14.

13 The Companies Act 46 of 1926 – based largely on the act in force after 1909 in the Transvaal (itself almost a carbon copy of its English contemporary counterpart); see Commission of Enquiry into the Companies Act, R.P. 45/1970 para 10.03.

14 Pretorius et al, *Hahlo's Company Law* 2; and see below for a detailed treatment of the Commission's contribution to the provisions regarding debt securities.

15 The Companies Act 61 of 1973 has, of course, been mostly repealed by the now operative Companies Act 71 of 2008.

16 See § 3 1 3 below.

debt securities (what the legislature called "debentures") was exclusively on the instrument itself, as an evidentiary documentary mechanism functioning "around", and accessory to, the debt. The 1895 and 1926 Acts therefore focus primarily on arrangements regarding this accessory element. In many ways it appears from the pre-1973 approach that, structurally, the *object* being regulated was understood only as the document, as an augmentation of the underlying debt.

Thereafter, it is treated increasingly as shares are – bundles of rights that are packaged, evidenced and transferred in a unique manner, such that the document and the debt form a holistic and tradable construct, signified by the legal term "security". Company law, thus, began to take a more cohesive view of the instrument, the document, the interests it signifies, and its commercial environment. This is especially true as company and securities exchange law became increasingly integrated, well-illustrated by the 1973 Act's transfer arrangements, and most pointedly in the subsequent advent of the uncertificated security.

From the 1973 Act onwards, the document and the instrument are gradually and explicitly conflated, and no longer function around the debt as definitively as before. In many instances, the debt and the (documentary) instrument are treated as a unitary legal object – a security – so that the instrument and the debt co-exist as the constituent elements of a security. This is shown in its grouping of shares and debentures[17] for certain purposes, often as *securities*.[18] The shift culminates in the 2008 Act, where an undifferentiated approach is followed throughout, and the debt and the instrument are treated as a single construct, the security, which is at all times the subject of the Act's provisions.[19]

3 1 1 The Company Debenture Act of 1895 and Companies Act of 1926

As a result, the legal position pre-1973 is a valuable source of information regarding (1) the origin of certain inherited idiosyncrasies in the current legal framework; (2) the nature of the documentary instrument; and (3) how one should approach the common law when looking to bridge gaps between

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17 For example s 133-140A of the Companies Act of 1973 ("Transfer of Shares and Debentures"), which also serves as a testament to the share-centric mindedness of the legislature. Alarmingly nowhere in these sections is mention made of the register of debenture-holders or even the term "debenture"; instead a transfer of an "interest in a company" (presumably the reference to debentures and other debt securities) must seemingly be entered into the members' register, which patently cannot be correct. The same problems are encountered in the later inserted s 91A, dealing with uncertificated securities (see § 3 2 3).

18 Specifically, as per s 134, for s 135-138 & 140 – the transfer of "listed securities".

19 See § 3 1 2 and 3 1 3 for a detailed treatment on this topic. Chapter 4, and to lesser degree Chapter 5, will outline proposed theoretical ramifications of this shift in terms of the current legal position. Finally Part 2 of this work contains discussions of the impact of this on select legal problems.

what has subsequently been legislated and what has been left to the residual rules of South African law.

The appropriate point at which to begin to analyse this development is the first Union-wide piece of company legislation – the Companies Act of 1926. However, this perspective must be informed by a discussion of the contents of the Cape's Company Debentures Act of 1895. Both Acts feature extensive structural and substantive overlap with the prevailing English legislation. Therefore – both terminologically and jurisprudentially – what follows below contains many elements of English law which in the course of modern South Africa's legal development were subsequently purged from or harmonised with the Roman-Dutch common law.

3 1 1 1 The Company Debenture Act of 1895

The Company Debenture Act, enacted for the purpose of statutory recognition and control over the issue of debentures by joint stock companies in the Cape Colony, is dated 6 August 1895 and contains only eight sections. The text is difficult to find, and the relevant sections have been quoted as far as necessary, if not slightly excessively.

The Act, repealed by the Companies Act of 1926,[20] contains a number of relevant measures. First and foremost, the Act *defines* debentures as follows:[21]

> "'Debenture' shall mean a *deed or document acknowledging* indebtedness of a certain sum of money, and duly executed in accordance with law and with the provisions of the Memorandum and Articles of Association or Trust Deed, if any, of the Company granting or issuing the same."

It appears to be the only Act to have provided a substantive definition of debt securities. Without being overly semantic, the definition indicated a "debenture" was the document recognising the debt, which "ordinarily means a security for money, called, on the face of it, a debenture."[22] This document did not embody the debt in a manner comparable to negotiable instruments, nor did it have to be the contractual instrument creating the debt (although it could and in many cases did function also as the contract).[23]

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20 Schedule V of the Companies Act of 1926.

21 Section 1 of the Act [own emphasis].

22 M Nathan *The Company Law of South Africa* 3 ed (1939) 259. See also comments by JC de Wet & JP Yeats *Die Suid-Afrikaanse Kontraktereg en Handelsreg* 2 ed (1953) 483 regarding the difficulty of comprehensively circumscribing "debentures" due to their variable content and characteristics.

23 *Levy v Abercorris Slate Company* (1887) 37 ChD 260 264, although a document acknowledging a debt may not necessarily be a debenture.

This is further evident from the judgment of *Coetzee v Rand Sporting Club*,[24] where the court discussed the meaning of the term "debenture". The sporting club in question agreed to issue the plaintiff 160 (ostensibly unsecured) £10 debentures with interest of 12,5% payable half-yearly, stipulating that the holder may, should any interest payments be in arrears for more than one month, demand the principal amount (£1 600) and outstanding interest immediately. The redemption date is unclear from the facts. The club had yet, at the time of litigation, to deliver the debenture documents or pay any interest. The claim was thus for the principal amount and outstanding interest.

In discussing the term "debenture", the judgment reads:[25]

> "I am not aware that the word "debenture" has been defined precisely. BOWEN, L.J., says in *English and Scottish Mercantile Investment Company v Brunton* (1892, 2 QB 700, at page 712): 'It seems that there are three usual forms of debenture...The first is a simple acknowledgment, under seal, of the debt; the second an instrument acknowledging the debt, and charging the property of the company with repayment; and the third an instrument acknowledging the debt, and charging the property with repayment, and further restricting the company from giving any prior charge.' It does not follow that there may not be other forms, but it is not necessary to go into that. I think *the word imports an acknowledgment of debt*. It is derived from *debentur*, Stroud says it seems to have originated from *debentur mihi* with which various forms of acknowledgment commenced."

At this stage in the development of the law, a debenture was simply a specialised form of the acknowledgement of debt, which is a well-known and understood legal and commercial tool.

The court – on the main question of whether the holder could claim the principal and interest without first having to sue for delivery of the document or damages for non-delivery – found that the agreement within the document had bound the club to its terms at the point where the subscription (or allotment) contract was perfected, which also bound the club to provide the physical debenture documents to the plaintiff.[26]

Therefore *consensus* on the debt and related performances were bound up in the agreement to issue the debentures themselves.[27] The court rejected the argument that agreement, between issuer and subscriber, to issue debentures was merely a promise to deliver the debentures (a *pactum de*

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24 1918 WLD 74.

25 76-77.

26 77.

27 "In the case of debentures, there is a debt due from the company, *with no special name*, secured *or* evidenced by a document called a debenture." – Nathan *Company Law* 259 [own emphasis]. Here the division between the underlying juristic engagement and the debenture document, as well as the documentary function of the certificate to secure (i.e. provide real security) or merely evidence (in the case of unsecured debentures) the existence of the instrument, is particularly clear.

contrahendo).[28] That would imply that any person who has agreed to subscribe to, and has paid for, debentures would not be in a position to enforce her rights unless the debentures have already been delivered, even though according to first principles the underlying juristic engagement (via offer and acceptance) has already been concluded once the offer to subscribe to (or, depending on the surrounding circumstances, offer to issue)[29] debentures has been accepted.

This approach was unequivocally confirmed by the Appellate Division in *Randfontein Estates Gold Mining Co Ltd v Custodian of Enemy Property*.[30] The question was whether certain bearer (i.e. payable to bearer, and therefore also negotiable) debentures held by German nationals had by virtue of the Treaty of Versailles become the property of the Union.[31] The court elucidated the relationship between the underlying juristic engagement and the (bearer) debenture itself as follows:[32]

> "[A] bearer debenture is an acknowledgment of debt in favour of the holder as a creditor of the Company for the specified amount with a right to interest therein as stipulated. They both [bearer shares and bearer debentures] relate to *jura in personam;* but in neither case is the document the *jus;* in both cases the *jus* is the right which is evidenced by the document."

If this is the case with bearer debentures (where by virtue of negotiability the *ius* is even more strictly tied to the document)[33] it surely must be the case with ordinary debentures. The court established that the "debenture" is the *evidence* of personal rights. Although the debenture's contents can be determinative of such personal rights (as the contract or documentary evidence thereof), the debenture is neither necessarily nor always the contract creating those rights.[34] This also addresses why it can be said that the aim of the legislature, at this stage, was merely to regulate the document augmenting the debt.

Potential subscribers at this time would clearly have been a different breed from those individuals "investing" (or rather speculating) in equities. Thus, real security for debenture-debts was centrally important – so much so that the real security arrangements seem to be the main impetus behind the

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28 *Coetzee v Rand Sporting Club* 1918 WLD 74 76 – as alleged by counsel for the defendant (excipient).

29 See ES Henochsberg *Henochsberg on the Companies Act* 2 ed (1963) 229-230; and MS Blackman, RD Jooste, GK Everingham, JL Yeats, FHI Cassim & R de la Harpe *Commentary on the Companies Act: Volume 1* (RD 8 2011) 5-241 – 5-242; and on the variable construction of offer and acceptance.

See Chapter 4, § 4 2 for a more detailed critical discussion of the *Coetzee* case and the current legal position regarding this issue.

30 1923 AD 576.

31 577.

32 581-582.

33 DV Cowen & L Gering *The Law of Negotiable Instruments in South Africa: Volume 1* 5 ed (1985) 26-27 – emphasising that there is "no complete merger between" the right and the paper. See also Chapter 1, § 1 1.

34 As from the discussion above.

Act.[35] The provisions of the Act show that it catered extensively (if not exclusively) for debentures "issued under bond", defined as mortgage bond or deed of hypothecation.[36] What follows is a section-by-section examination of the Act.[37]

Section 2 was the authorising provision, and reads as follows:

> "Any Company acting in accordance with the provision of any law specially relating to such Company, and with its Memorandum of Association and Articles, or Trust Deed, if any, may from time to time grant and issue debentures and cause the same to be registered under this Act, and such debentures when duly registered shall as from the date of such registration operate subject to prior registered rights under and by virtue of any bond or debenture theretofore registered, as a first or preferential charge in respect of so much of the property of the Company as shall be mentioned and described in such debenture, in accordance with the regulations, if any, in that behalf, as bound by way of security for the fulfilment of the obligation undertaken by the Company under such debenture."

Section 3 catered for the registration and lodging of debentures at the Registrar of Deeds. It provided that debentures *may* be issued in duplicate, which duplicate was to be lodged with the Registrar,[38] and would "bear a stamp as a bond".[39] Despite the company not creating and lodging such a duplicate, the position of a debenture holder was such that the holder:[40]

> "shall be entitled to enforce his rights under such debenture so soon as it shall be issued to him *precisely as though such debenture had been issued under section three*, nor shall any notice of cession of any such debenture be required to be given to any person in order to entitle the cessionary to all the rights of the cedent."

Registration of the duplicate, it seems, would enhance the publicity associated with the debentures, but was not mandatory.

The fact that the Act intervened in the workings of the common law regarding the principles of cession (as, under English influence, they were then understood) is evidence that the Act required the document to function in a specific, or rather specialised, way. Whilst the principal focus remained the workings of the acknowledging document (as something separate from the underlying juristic engagement of debt), that document was given special qualities in order for it to function with greater

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35 See Chapter 2, § 2 3 1, and § 2 3 2.

36 Section 1.

37 Surprisingly, there does not seem to be an English equivalent to this statute, and although the term "debenture" appears in various statutes, it only begins to receive "frequent" English legislative attention in and after the Companies Act of 1900 – see FS Cooper *Debentures* (1920) 1.

38 See s 1 of the Act.

39 Section 3.

40 Section 6 [own emphasis].

certainty and efficiency. The arrangements for ease of cession are a good example, but the real security arrangements at the heart of the Act are where this point is best illustrated.

Section 5 made it clear that under a single bond, a company was able to issue debentures in series, or singly.[41] Thus, in the overall scheme of the Act, a company was able to create any number of secured debentures under a single bond. These "may be issued from time to time and at different dates…yet shall all rank concurrently in preference as from time of registration of the bond", as long as the original *unissued* debentures under that bond were in the custody of the Registrar of Deeds.[42]

It is likely that most debentures were secured,[43] and issued under bond, so that: (1) companies would register a bond over a portion or the whole of their property; (2) in favour of the *future* holders of a predetermined number of debentures (i.e. a specified class of future persons, and not specific persons); (3) which debentures the company would then issue to subscribers (whether directly or through the use of a trust vehicle); (4) so that each subscriber, by taking up the offer to subscribe to the debentures, effectively loaned the company a specific sum of money with interest, and gained a participatory interest in the real security proportionate to their holding of the total number of debentures registered under the bond.

Within this legislative scheme, the "debenture" was the accessory document, and the function of that document was to augment an ordinary contractual juristic engagement between a company as borrower and person (or institution) as lender in the following ways. First, it allowed a company to register real security over a future debt (totalling the amount bonded), in favour of a notional, abstract group of future creditors. Second, it allowed the company to borrow – with real security – money in piecemeal portions from various creditors up to the stated bonded amount. Third, it arranged for all the notional creditors' claims to rank concurrently from date of registration of such a bond. Fourth, it caused each debenture document to be fungible (in the sense that the securities of the same issue were virtual equivalents, despite serial numbering), with its corresponding set of obligations transferable without notice, but evidenced by paper.

Moreover, it effectively allowed a lender, as holder of the debenture, to obtain a fractionalised portion of the overall preferential claim on the secured property and to enforce such a claim *without delivery* of such property. This is quite significant. It implies that the charge on the property of the company

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41 See also LP Pyemont "The Companies Bill for the Union of South Africa" (1923) 40 *South African Law Journal* 389 395; and De Wet & Yeats *Kontraktereg & Handelsreg* 485 in the context of the 1926 Act.

42 Section 5 – the parallel between the custody requirement and the authorised-versus-issued shares distinction is instructive. As shares are required to be authorised before they are issued, so are debentures required to be registered and on file with the Registrar of Deeds. Both arrangements protect stakeholders regarding the legitimacy and consequences of the specialised operation of these respective instruments.

43 Although the Act seems to allow unsecured debentures, and companies undoubtedly issued such debentures, it is highly likely that this occurred less frequently, as such debentures would have been less popular, especially with an investing public seeking the sovereign-like creditworthiness of secured debentures.

was (from the perspective of the debenture-holder creditor) already perfected at the time of liquidation. Furthermore, the "charge" seems to have included "stock-in-trade, chattels, and book debts of the company and its future property".[44] In the case of movables and such intangibles serving as real security, the Act thus empowered the creation of a true *floating charge* on the assets of a company by means of an issue of debentures. It also determined that, if all the Act's requirements were met, the date at which preference in the queue of (secured) creditors was to be determined would be the date of registration of the bond, not the date of issue of the debenture.[45]

Therefore, in sum, it seems that a debenture functioned as an accessory documentary mechanism, or instrument, operating within the sphere of contractual common law but *modified* by commercial statute, used primarily to reduce the economic transaction costs (before, during, and after the transaction; as well as in case of insolvency) incurred by both debtor and creditor in corporate borrowing. It followed largely English legal principles to do so. One final observation that must be made about this era is that it evidences a pronounced lack of emphasis on the role of the company's *register* of debenture holders, showing an almost myopic focus on the function of the debenture document. This is simply because, until shortly after the turn of the century, it was not yet settled whether South African law recognised the English law principles of constructive trust, and consequently legal and equitable ownership. Thus the South African role of the register (as it emerged during the 20th century) was also a means by which to harmonise, albeit imperfectly, the more Roman-Dutch character of private law and the reception of the English law construct of the registered security.[46]

The Act's intervention in contemporary principles of cession (which facilitate trading rather than the provision of real security) appears less important within its overall scheme. This is the inverse of the present legislative focus (which emphasises the transferability of debt securities more than real security arrangements), in keeping with the hypothesis of a change in the application of debt securities in the modern financial sector.

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44 Pyemont *Company Law* 206; Emmet *Company Law* 195; Nathan *Company Law* 260; and De Wet & Yeats *Kontraktereg & Handelsreg* 484 – the context of these authorities is the 1926 Act; however, from the wording of the 1895 Act, this is equally applicable here.

45 See Emmet *Company Law* 194-195 & n 4; as well as Nathan *Company Law* 260 for a general analysis of the nature of the floating charge authorised by the 1926 Act. The date of determination of priority of creditors in the *concursus creditorum* was confirmed in *Consolidated Textile Mills v Registrateur van Aktes, Natal* 1935 NPD 556.

46 See Chapter 4, § 4 1 1.

3 1 1 2 The Companies Act of 1926

Armed with an understanding of early case law and the Company Debenture Act, attention can be turned to the Companies Act of 1926 ("the Act" in this section). This Act, as a Union-wide statute, must be viewed as the true starting point for any legal-historical inquiry as to what these instruments' current legal nature and mechanics are.

The original version of the Companies Act of 1926 is more detailed than the Cape Debenture Act and supports the analysis above. From its long title, it is clear that the Act's overall purpose was largely to "consolidate and amend the laws in force [such as the Company Debenture Act in the Cape] in the several provinces of the Union" in matters of company law, making it the point of origin for the modern statutory position on debt securities in South Africa. Its primary arrangements regarding debentures are found in s 91-94.

The interpretive significance of its predecessor, the 1895 Act, is illustratively validated by *Consolidated Textile Mills v Registrateur van Aktes, Natal*, a judgment delivered in 1935.[47] The court had to determine whether the provisions of s 91 of the Companies Act operated to the exclusion of the common law relating to a company's general power to bind its property as security for the issue of debentures – i.e. whether the methods prescribed in the section were the only way a company could create security for these instruments.[48]

The court, on the state of the common law in force in South Africa before the 1926 Act, stated:[49]

> "It is therefore necessary to consider what were the provisions that were contained in the previous laws of the Provinces in regard to the matters which are dealt with by section 91 of the Act. Now with one exception, *viz.,* the Cape Act, 43 of 1895, there was not in the laws of the other Provinces any such provision at all. The Cape Act of 1892, which was, until its repeal by the Act of 1926, the main Companies Act in that Province, has no such provisions. There were none in the Natal Act, in which the word "debenture" does not even appear. The Transvaal Act of 1909 does contain provisions dealing with debentures – see sections 90, 91, 93, 94 and 95 – but nothing in regard to their creation or the types of bonds to be registered in the Deeds Office as security for debenture repayments. Nor is there anything of that nature to be found in the Free State Laws. Presumably, therefore, the kind of bonds passed by companies to secure the repayment of debentures in the Transvaal, Free State and Natal prior to 1926, and in the Cape prior to the passing of Act 43 of 1895, *would be such bonds as were ordinarily passed by individuals and registered in the ordinary way and would bestow rights ordinarily created by such bonds in respect of the property, movable or immovable, hypothecated thereunder.*"

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47 1935 NPD 556.

48 553.

49 555 [own emphasis].

The court concluded that the section does not operate to exclude or limit a company's inherent or common law powers to create real security generally, but does limit such powers in so far as the real security serves the issue of *debentures*.[50] Thus the court deemed the procedure found in s 91 as the only manner in which a company may create real security for debentures, to the exclusion of other arrangements.

There are various sections in the Act that deal with debentures,[51] but the central provisions are in sections 91-94. They are found in Chapter III of the Act ("Management and Administration"),[52] and bear the title "Mortgages and Debentures". This alone makes it obvious that, although the Act allowed for unsecured debentures,[53] the relationship between the debt instrument and real security was of paramount importance; the contents of the sections confirm this.

Section 91(1) reads:

> "A company if so authorised by its articles may subject to the provisions of this section, create and issue debentures binding as security for the fulfilment of the obligation undertaken by the company thereunder so much of the movable or immovable property of the company as described therein."

It is clear that the company's ability to issue debentures flowed from its so-called general borrowing powers, if such borrowing was within the scope of its business and for a proper purpose.[54] Naturally the directors, as the prime conduits of a company's capacity to act, were charged with "issuing" (more accurately: authorising and facilitating the issue of) the debentures, which purportedly would vary, at the time between £10 and £100. [55] If issued to the public at large, as with shares, it occurred via a prospectus, on which the Act was quite specific.[56]

There was no definition of "debenture" in s 229 (the definitions section), it merely stated that "debentures" include "debenture stock". The latter was a slightly simpler scheme, wherein the holder of debenture stock holds (i.e. has a proprietary right to; an equitable interest in) a fixed yet divisible amount of debt forming part of a larger – single – borrowed sum or fund, which is the overall

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50 557.

51 Which appears in the Afrikaans text as "*obligasies*".

52 Section 1 of the Companies Act 46 of 1926.

53 Pyemont *Company Law* 205; Emmet *Company Law* 194; Nathan *Company Law* 259; and Henochsberg *Companies* 276.

54 Pyemont *Company Law* 204; Emmet *Company Law* 193 & 193-194; Nathan *Company Law* 259; Henochsberg *Companies* 275 & 275-276; and De Wet & Yeats *Kontraktereg & Handelsreg* 483.

55 Pyemont *Company Law* 210 and 204 respectively; Emmet *Company Law* 193; and De Wet & Yeats *Kontraktereg & Handelsreg* 484.

56 See the prospectus arrangements – also in Chapter III, s 76-80. This is not dealt with in detail here.

debenture stock.[57] This was usually achieved using a trust device. Holding debenture stock (as opposed to debentures) would imply the holder had, for example, a proprietary interest in 10% of a £10 000 loan to the company. This interest was evidenced by a certificate, and most often given legal effect through status as a beneficiary of a trust to which the company owed the total amount. Such a percentage could be further subdivided and wholly or partially transferred to others, contingent on the re-issue of updated debenture stock certificates by the company, also usually through the trust.

"Debenture stock" was not a legal equivalent or in nature similar to debentures. Comparable English authority – which at this stage of the legal development was determinative of the South African view[58] – made the fundamentally important observation that:[59]

> "[t]he word 'debenture'…*denotes a document* of a particular kind under the seal of a company. The term 'debenture stock,' on the other hand, does not denote a document of any kind. *Debenture stock means the debt itself…*The common collocation of the words 'debentures and debenture stock,' is therefore technically inaccurate, although it could hardly be misleading to anyone."

The corollary of this statement is that a debenture was not regarded "as the debt itself", and so the position in England (unsurprisingly) mirrored that of South African law in this regard. Debenture stock was thus not, as is the case for shares and debentures, issued in units, and was expressed instead as a percentage.

Section 91(1) has been interpreted to authorise the issue of unsecured debentures ("a mere promise to pay" conferring the status of an unsecured debtor concurrently with other unsecured debtors at winding-up); or secured debentures, to which the latter part of the authorising provision quoted above would then apply.[60] Using as context the definition in the Company Debenture Act and the English position as above, the meaning of "debenture" under this Act remained a written acknowledgment of indebtedness. In short, the Act created a special documentary instrument, accessory to an

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57 Some mention of this is made in *Coetzee v Rand Sporting Club* [1918] WLD 74, cited by Pyemont *Company Law* 205 & n 3 and Emmet *Company Law* 194 & n 4. Comparatively, see for example in England: FB Palmer *Palmer's Company Law* 22 ed (1976) Vol 1, para 44-04; New Zealand: J Farrar & S Watson (eds) et al *Company and Securities Law in New Zealand* 2 ed (2013) 634; and Australia: RP Austin & M Ramsay *Ford's Principles of Company Law* 14 ed (2010) 10.03.

On divisibility – debenture stock, as per the above authorities, can be fractionally disposed of by the holder of the stock, broadly in keeping with the stock principle as applied to equity, an option which in the above foreign jurisdictions is ostensibly not available to holders of debentures, which seem to be unitary and indivisible, even today. See also J Benjamin *Interests in Securities: A Proprietary Law Analysis of the International Securities Markets* (2000) 34-35.

58 This is, to a large degree, still the case – see for example FHI Cassim (ed) et al *Contemporary Company Law* (2012) 230-236, including useful authority cited therein.

59 Cooper *Debentures* 7 [own emphasis]. Compare to Nathan *Company Law* 259 – "The issue of debenture stock is not borrowing; it is the sale in consideration of money of the right to receive a perpetual annuity, which may or may not be redeemable...".

60 Pyemont *Company Law* 205; Emmet *Company Law* 193 & 194; and Henochsberg *Companies* 276.

ordinary (contractual) agreement to loan the issuer a fixed sum, which served (1) to standardise and regulate the on-going relationship between creditor and company-debtor; and (2) to augment the residual rules of contract (and other aspects of the common law).

As such, the first observation regarding the Act's effects centres around contractual offer and acceptance. The Act's prospectus requirements (should the company offer debentures to the public) determined the validity of offer or acceptance for the valid conclusion of an allotment contract. It imposed requirements of both form and substance, depending on the structure of the subscription and wording of the prospectus. This directly affected the valid conclusion of the underlying debt contract, as allotment is the point at which such a contract will be concluded. However, the legal history of the prospectus adds little to the current position and will not be covered here.

More importantly, the Act's intervention went far further (than even the Cape debenture legislation) by not only (1) dispensing with any notice requirements standing in the way of a cessionary's exercise of his rights,[61] and (2) arranging concurrent preference for debenture holders under the same real security,[62] but also (3) expressly invoking the remedy of specific performance regarding contracts to take up or subscribe for debentures.[63] Until this point, the prevalent view seems to have been that a company would only be able to claim damages from subscribers in breach of the allotment contract.[64] Thus this last aspect seems to have been principally aimed at securing specific performance for the benefit of the issuing company, and the dominant view was that this statutory remedy could generally not be used by debenture holders at the other end of the transaction.[65]

However, it has essentially been settled in South African law that specific performance is the primary remedy in contract law,[66] and that cession may take place validly without notice.[67] This was clearly not yet seen by the legislature as definitively being the case (or as somehow requiring clarification by confirmation) – the uncertainty regarding where Roman-Dutch principles end and English law

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61 Section 91(6).

62 Section 91(5).

63 Section 94.

64 *South African Territories v Wallington* [1898] App. Ca. 309, a question which was asked but not answered in *Brereton v Carnarvon Syndicate* [1889] 10 N.L.R.

65 See Pyemont *Company Law* 226; Emmet *Company Law* 205; Nathan *Company Law* 267-268; and Henochsberg *Companies* 283. "Specific performance" also did not include judicially compelling a company to confer upon a holder status as preferred creditor where the company did not, as promised, bond its property as real security for the debt. Furthermore, where debentures were issued payable in instalments, and the debentures and instalments had somehow been forfeited by the subscriber, the company could not avail itself of this remedy.

66 D Hutchison & C-J Pretorius (eds) *The Law of Contract in South Africa* (2010) 319; SWJ Van der Merwe, LF Van Huyssteen, MFB Reinecke & GF Lubbe *Contract: General Principles* 4 ed (2012) 327 & 329-332; and GF Lubbe & CM Murray *Contract: Cases, Materials, Commentary* 3 ed (2010) 542. See also S Van der Merwe *A comparative evaluation of the judicial discretion to refuse specific performance* LLD thesis Stellenbosch (2014) for an analysis of the broader doctrinal and comparative position regarding specific performance as the primary South African contractual remedy.

67 Van der Merwe et al *Contract* 414 & n 239.

influence begins was not yet clear. The statute seemingly catered for problems arising in English, rather than modern South African law and viewed currently many of these interventions appear redundant.[68]

Debentures also often seem to have included a clause which would bar the company from enforcing against the cessionary any set-off it had against the cedent. This is significant, as it essentially amounted to transfer "free from equities between the company and the original or any intermediate holder",[69] or far more importantly: "subject only to equities…between the company and the person who is registered holder".[70] This implies that legal title (i.e. registered ownership) could be transferred wholly or partially free from any defences and defects that could have stood against the transferor.[71]

Whilst this attribute (transfer free from defects in title) has been called "the major privilege of negotiability",[72] it alone does not make a documentary record of rights a negotiable instrument. A second quality is further required: "simplicity of transfer" – i.e. transfer by physical delivery of the document.[73] This is why securities which are not payable to bearer are not considered negotiable instruments.[74] Yet transfer "subject only to equities…between the company and the person who is registered holder" does have significant legal consequences. On the spectrum that exists between binding oral agreements and fully negotiable instruments, this affects the character of such a documentary augmentation, and the relationships it creates. This is especially true in determining the kind of properties such a document, functioning at the oblique intersection between the law of property and obligations, may have.

The importance of this theme cannot be overstated and is central to many aspects of this work. Concerning equity instruments, an equivalent arrangement is found in s 27 – "[n]o notice of any trust, express, implied, or constructive shall be entered on the [share] register or be receivable by the

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68 This view is echoed in JL Yeats, R de la Harpe, R Jooste, H Stoop, R Cassim, J Seligmann, L Kent, R Bradstreet, RC Williams, MF Cassim, E Swanepoel, FHI Cassim & K Jarvis (2018) *Commentary on the Companies Act of 2008* at 2-367:

> "Section 94 of the 1926 Companies Act provided that a contract with a company to take up and pay for any debentures could be enforced by an order for specific performance. This provision was first introduced in England by the 1907 Act. Until then the remedy of the company was (unless it had declared that the application money should be forfeited in such a case) in damages only. The reason for this was that the intending borrower may obtain its loan elsewhere on the market, and is adequately compensated for the lender's breach of contract by an award of damages. The provision enabling a company to obtain specific performance was enacted because the above reasoning does not hold true when a company seeks to raise a large loan from a number of subscribers. *The provision was not re-enacted in the 1973 Act, because it was thought to be 'superfluous', and has not been re-enacted in the 2008 Act*." [own emphasis]

69 Pyemont *Company Law* 215-216.

70 Emmet *Company Law* 201 – see § 7 of the model debenture document found therein.

71 Cowen & Gering *Negotiable Instruments* 20-21 & 34-35

72 *Standard Bank of SA Ltd v Sham Magazine Centre* 1977 (1) SA (AD) 493F.

73 See Cowen & Gering *Negotiable Instruments* 24-28, 29-36, and 36-43 – helpful in providing authority for, and an explanation of, the "twofold enumeration" of requirements for classification as negotiable instruments.

74 *Union South African Association Ltd v Cohn* 1904 TS 733 738; *Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd* 1976 (1) SA 441 (AD) 452; and Malan *Collective Securities* 182.

Registrar". It is trite that this is a clear borrowing of the wording of English companies legislation. This provision has widely been understood to mean that companies only need to perform towards registered shareholders, and no-one else. It is important to note that while for shares this was a structural feature of the Act applicable to *all* equity instruments, debentures required the specific insertion of the applicable wording into the debenture document.[75]

In either case, the effect was the same. Whether through s 27 or the wording of debenture documents, this created a unique partition, in a sense, between the *powers* of registered holdership (hinging on the company's obligation to act exclusively toward the registered holder), and the *rights* of beneficial interest holders of securities (which serve as the patrimonial objects underlying the share or debenture). This is inherent in the architecture of all registered securities, but the manner in which it is achieved has undergone significant change.[76] However, for present purposes it is enough to state that it exemplifies the unique (and historically consistent) nature of a debenture on the spectrum of documentary augmentation of obligations, especially as being something more than a written contract, yet less than a negotiable instrument.

Most of the attention in the Companies Act was devoted to secured debentures, and the manner in which the document, in conjunction with the Act, governed the real security regime. The instrument and its real security appear so closely linked that the authors of *Pyemont* state as follows:[77]

> "[Debentures] *are* bonds given by the company and evidence that the company is liable to pay the amount specified with interest, and generally charge the payment of it upon the property of the company…*Debentures are the bonds or deeds which evidence the loan, and*, if they purport to give a charge, *create the security* for its repayment."

In light of the close relationship between "bonds" as denoting real security and debentures, it is no surprise to find terminologically that bonds (i.e. debt securities termed bonds, not the term's other meaning as directly related to real security) and debentures are for legal purposes indistinct. At the same time, confusingly, in commercial practice each (usually) indicates different qualities.[78] The term "bond" connotes a debt security that is ordinarily secured, often longer-term, and often issued at a

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75 The fact that the nature (or existence) of this partition was contingent on such wording being inserted into the debenture document, rather than (as is the case with shares) built into the Act itself, creates some confusion as to the operation of other areas of the Act. See § 3 1 2 below for more detail on these ambiguities – for instance, whilst s 27 clearly only applies to shares, s 93(2) considers the transfer of debentures to a "nominee" for the purpose of keeping alive debentures for re-issue. It is submitted that this is only possible if such wording was used.

76 The 1973 Act's similar "execution of a trust" provision (s 104) also only applies to shares, such that until the 2008 Act (which approaches the beneficial interest holder-nominee relationship through the definitions of the Act, as well as in terms of the broad outcomes of Chapters 4 and 5) nominee-holding of debentures appears to have remained a function of correctly drafting the debenture documents. As will be seen, this remains true for non-company debt securities today.

77 Pyemont *Company Law* 204 [own emphasis].

78 Unfortunately, "usually" is an unworkable qualification in law when in search, as is the case here, of bright lines.

discounted value or a premium. In contrast "debenture" ordinarily connotes unsecured, often shorter-term debt securities, mostly issued at face value.[79]

This makes sense of the fact that "bonds" ostensibly enjoy a livelier secondary market trade than debentures, despite the fact that they are, in principle, legal equivalents and share essentially the same discounted future value and pricing characteristics. In fact debentures were often also issued at a discounted value, and/or repayable at a premium.[80] It follows that the opaque commercial criteria used today to identify a bond in contrast to a debenture are not consistent enough to be of any legal value. The emergence of the term "note", often denoting exactly the same as bond or debenture, further muddies the terminological waters.

The way in which the real security (the bond) and the debenture were linked was not always the same. The debenture document itself could create the charge on company assets (a "duly executed", or notarial debenture) or it could stipulate that its holder obtained the real rights in terms of a free-standing bond (much like was provided for in the Company Debenture Act). In the alternative, the bond could be effected by an amalgamation of these two methods,[81] presumably where a separate mortgage document was attached to a notarial debenture. The 1926 Act also retained the provisions empowering the creation of a true floating charge on a companies' movables and certain intangibles.[82]

A debenture would also ordinarily list the events that activate the bondholder's security rights, such as default, insolvency, liquidation, and so on, as well as an undertaking by the company not to re-bond the property in a manner that affected the charge created by the debentures.[83]

Further, the Act required extensive publicity with regard to debentures. It provided that any secured debentures had to be registered in the appropriate deeds registry. Should the debentures bind movable property it was to be done under notarial execution, "as if they were notarial bonds",[84] and if they bind immovable, or immovable and movable property they were to be registered "by means

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79 See for example Investopedia "What is the difference between a debenture and a bond?" *Investopedia* <http://www.investopedia.com/ask/answers/122414/what-difference-between-debenture-and-bond.asp> (accessed 31-01-2021). Also, compare JSE "Bonds" *JSE* <https://www.jse.co.za/trade/debt-market/bonds/corporate-bonds> and <https://www.jse.co.za/trade/debt-market/bonds/government-bonds> (accessed 31-01-2021) with JSE "Debentures" *JSE* <https://www.jse.co.za/trade/equity-market/debt-em/debentures> (accessed 31-01-2021), where the real security distinction is maintained, but not the time period.

80 Nathan *Company Law* 263; and Pyemont *Company Law* 211 – it was, however, illegal to issue debentures at a discounted value if also exchangeable for shares at face (or "par") value.

81 Pyemont *Company Law* 205; and Emmet *Company Law* 194. See also Henochsberg *Companies* 275; Nathan *Company Law* 263; and De Wet & Yeats *Kontraktereg & Handelsreg* 484.

82 Section 91(1) as read with (3), (5) and (6); see also § 3 1 1 1 above.

83 Pyemont *Company Law* 206; Emmet *Company Law* 194-195; and Nathan *Company Law* 261.

84 Section 91(2).

of a mortgage bond or bonds…hypothecating the property concerned."[85] If debentures were issued at a discount, or alongside any commission to underwriters, guarantors, or similar persons, this would also have to be displayed in each annual report, including on all balance sheets any amounts not written off.[86]

This is not to say that a "duly executed" debenture would automatically qualify as a duly executed *bond* in all cases – it depended on the nature of the real security. A true mortgage over immovable property would have to be duly executed independently of the debenture in order to bind, effectively, a company's immovable property. This was not the case for notarial bonds over movable property: if properly executed, a so-called "notarial debenture" would suffice to bind the company's movable property.[87]

The registration in the deeds registry was in addition to registration in the register of debentures maintained by the company itself. The company's register would also include whether the debentures were to bearer[88] and, if not, the names and addresses of the holders.[89]

In light of the fact that secured debentures were registered in the deeds registry, the notion that "debenture" in the Act purports to refer to the document and not the debt, begins to make more sense. It also becomes clear why, as stated above, the secured debenture *itself is* a bond. The effect of the debenture becomes indistinct from the effect of the superordinate bond under which it was issued *to the extent of the holder's rights* (i.e. as a fractionalised portion of the overall preferential claim on the secured property). Simply, such a debenture became a "mini-bond" and was individually registered like an ordinary bond at the Deeds Office.

As stated, a debenture had an accessory nature, similar to an ordinary mortgage or notarial bond.[90] Principally, when the debt (capital and interest, including any premium) was extinguished, the debenture was also redeemed and, logically, any real security arrangements ceased to be of effect. Similarly, where the debt was void, the instrument became of no consequence. The Act dealt primarily with arrangements regarding this accessory documentary instrument and was inexplicit where the repayment of the debt is concerned. It would seem the terms on which a debenture may

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85 Section 91(3).

86 Emmet *Company Law* 197; see also Nathan *Company Law* 266.

87 Emmet *Company Law* 196; Henochsberg *Companies* 275; and Nathan *Company Law* 263.

88 *Randfontein Estates Co Ltd v Custodian of Enemy Property* 1923 AD 576 – as in Pyemont *Company Law* 223; and Henochsberg *Companies* 277.

89 Section 92(1), later amended to ensure clarity on the matter of it being a register of holders, not necessarily owners – see Emmet *Company Law* 202 & 203; and also Henochsberg *Companies* 281. See also Nathan *Company Law* 265 – "though the register is a register of debenture holders, the register is also a register of debentures…".

90 TJ Scott & S Scott *Wille's Law of Mortgage and Pledge in South Africa* 3 ed (1987) 5.

have been redeemed was an issue of contractual freedom between the parties. For instance, the company could repay the holder in fixed term "coupon" payments.[91] In the alternative, the debt could be repayable at the behest of either the holder or the issuer, and could even be "zero-coupon", indicating no regular interest payments, but instead a lump sum payment upon the termination date. Premature repayment in full could also be made contingent on specific trigger events. Any combination of these methods was, and remains, possible.

Naturally, the terms of redemption would make provision for other "redemption events" such as premature winding up of the company or the company ceasing to be a going concern, and could also include, for instance, other trigger-situations such as coupon payments being in arrears,[92] the disposal or re-mortgage of the real security, or exchange for fully paid up shares (with or without an additional payment or set-off).[93]

There was also the possibility of secured but irredeemable debentures – which functioned as annuities in perpetuity, rather than finite secured or unsecured debenture-lending.[94] Whilst the Act itself did not mention or recognise perpetual debentures, the issue of debentures is an exercise of the company's innate borrowing powers. It seemed therefore that the issue of such annuities required special authorisation in the Memorandum.[95] The term perpetuity is slightly misleading, as the life span of a company is only truly perpetual in theory, and not in practice.

Despite the debenture being essentially accessory, the Act contained an interesting intervention in the workings of this principle. A company was able to buy back its own debentures, presumably at the value of the outstanding obligations towards the holder. Under s 93, secured debentures that were bought back would technically be redeemed, but *were not necessarily extinguished*. Section 93(1) provided that these debentures could be kept alive so long as the bond remained, and the company could re-issue those same debentures without any difference between the new holders' rank amongst the older holders under that bond arrangement.

This is an important illustration of the operation of the documentary instrument vis-à-vis the debt. The unsecured debenture seems to have been fully accessory to the debt-based juristic engagement between a creditor-holder and a company-issuer. Yet the secured debenture seemed to be partially

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91 The permutations of a coupon can vary greatly – some more common examples include: only capital payments with all the interest in lump sum in the last coupon, only interest payments with the capital in the last coupon, amortised payments including portions of capital and interest.

92 As seen in *Coetzee v Rand Sporting Club* 1918 WLD 74 above.

93 See Pyemont *Company Law* 206-207 and 214-215; Emmet *Company Law* 195; Henochsberg *Companies* 276; and De Wet & Yeats *Kontraktereg & Handelsreg* 484.

94 *Samuel v Jarrah Timber Corporation* [1904] App. Ca. 330, as cited in Pyemont *Company Law* 208 n 2.

95 Pyemont *Company Law* 226; and Emmet *Company Law* 205.

accessory to the debt (in so far as the debt activates the legal subject's ability to perform juristic acts on the basis of the instrument), *and* partially accessory to the bond (in so far as the bond allowed the debenture to be "kept alive" as long as the bond remained operative).

This allows a further observation. The bond securing a secured debenture was itself also accessory to a debt, but could be registered to secure future (or existing and future) debts – thus bonds pre-registered for the future issue of debentures are to be considered "covering bonds".[96] The legislature's impression seems to have been that the common law position was, without explicit terms to the contrary, that redeemed debentures would automatically also be fully extinguished.[97] Again, whether this reflected the true South African common law at the time, or merely presumed that the English position prevailed, is uncertain.

The overall picture beginning to emerge is one where the legal position regarding corporate debt securities allowed great freedom to contract over the terms of the debt underlying a debenture. However, the Act gave this accessory instrument far-reaching power. The fact that the debt was supplemented by a debenture would affect aspects of the principal obligations, such as offer and acceptance, the remedial regime, cessionary principles, and even whether the patrimonial benefits and the right to enforce performance vested in different persons. Furthermore, the debenture itself made possible the creation of real security in ways not possible at common law and could even be recycled in successive rounds of fund-raising using the same bonded property.

A debenture under the Act of 1926 was not yet a cohesive, multi-dimensional and singular legal construct. There was, at one level, a regime of obligations in terms of which both parties had contractual rights and duties centred around *consensus* over the terms of a debt – i.e. the underlying juristic engagement. The terms of this engagement were often found in the debenture document, yet according to case law the creation of these obligations occurred through the allotment agreement. Thus, as far as the operation of the law relating to debentures is concerned, the inclusion of the contractual terms on the debenture document itself was merely incidental.

The Act itself, however, appears to have concerned itself most with determining the effects of the accessory documentary instrument – i.e. the debenture. Any alteration of the underlying juristic engagement's residual rules (by virtue of the debenture as effected through the Act), occurred only in furtherance of the *document's* efficiency. On this second level, the Act provides for an accessory instrument which was able not only to modify the regime of its principal obligations, but also able to standardise and evidence the parties' legal relationship, create easily transferable (or convertible)

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96 Scott & Scott *Mortgage and Pledge* 6.

97 Pyemont *Company Law* 225; Emmet *Company Law* 204-205; Nathan *Company Law* 267; and Henochsberg *Companies* 282.

patrimonial interests and (perhaps more importantly) easily transferable real security, as well as deal smoothly and efficiently with a (potentially vast) multitude of creditors.[98]

Lastly, if somewhat counter-intuitively, this further shows that secured and unsecured debentures were really two quite different instruments under this dispensation. An unsecured debenture can be seen as an accessory instrument manifesting in an evidentiary certificate and a debenture register entry. It evidenced that identical borrowing contracts had been concluded in series to a number of people at the same time, and brought about slight statutory modifications to the contractual regime.[99] It could also function, if worded correctly, to vest in different legal persons the entitlement to benefits and the ability to determine performance.

A secured debenture, on the other hand, was an instrument (also manifesting in a document and register entry) designed to operate as a fractionalised and separately registered portion of a superordinate bond (in the "real security" sense), to which it was in essence accessory. As such, it was able to function as a smaller, self-contained, and easily transferable mortgage or notarial bond (or both), which could be used multiple times under the same bond without being extinguished. When tied to a specific creditor-holder (i.e. having been allotted and issued), it also assumed all the properties of the unsecured debenture as outlined above, at least until redeemed, after which it could be re-issued or retired (extinguished) upon reaching maturity.

This would seem to elevate the status of secured debentures to instruments fulfilling more than a merely evidentiary function. Not only did they need to be validly executed in terms of the Companies Act, but also in accordance with the law regarding real security arrangements, in order to create the rights they evidence. In a sense, they could be regarded as *constitutive* documents, as "their valid execution is necessary for the initial creation, or bringing into existence, of the separate right [or rights] recorded therein, and which (if certain requirements are satisfied) are themselves the source of a legal right [or rights] additional to the right [or rights] arising out of an underlying transaction…".[100] At the very least their valid execution was necessary to create real security rights.

As constitutive documents, they did not quite go as far as "embodying" the legal rights to such a degree that there were special legal consequences to possession and ownership of the document itself (unless dealing, of course, with debentures to bearer), but did move in functional terms beyond

98 The intervention of a trust vehicle has not been dealt with above, although the Act contains much on this matter – it is more appropriate to deal with this matter elsewhere, as the law of trust as well as its uses in the issue of securities have undergone significant changes since then, and there is little which a historical analysis can contribute.

99 And therefore distinct from ordinary acknowledgments of indebtedness.

100 See Cowen *Negotiable Instruments* 53, and generally 27-28, n 96, n 97, and 52-54. In n 97 – citing *Adams v SA Motor Industry Employers Association* 1981 (3) SA 1189 (AD) 1199-1200 – it is noted that it is possible for an acknowledgement of debt to be considered a constitutive document, yet fall short of the standard of negotiability.

merely acknowledging (evidencing) the debt and governing successive cessionaries' relationship with the issuer. The secured debenture instrument of this regime facilitated or created – perhaps going as far as to *constitute* – the real security rights, without which it could not have been so arranged.[101]

This is why it can be stated that, under this Act's regime, a secured debenture *is* a bond – it had been made so by the Companies Act, and (in line with the legal position before the Act and illustrated by case law) an unsecured debenture was simply a written acknowledgement of debt importing a number of statutory consequences.

This reveals much about the economic function of debentures in the financial system of the time. Debentures, much like the trust vehicles they were often administered through, functioned as devices for the reduction of transaction and other economic (for example monitoring) costs incurred between corporate borrowers and their respective lenders in the course of corporate debt-financing. A debenture allowed a company to conclude a great number of *uniform* borrowing contracts at the same time or over a period of time, with a strengthened remedial position, the ability to track its creditors through use of a register and certification, and (in most cases) the ease of performing towards a specified creditor whose is unable to further divide and distribute his right to determine performance. Far more importantly, however, *secured* debentures allowed the company to take out a single bond in favour of an entire class of notional creditors, under which it could conclude such standardised (and recyclable) contracts, conferring easily transferable real security on individual debenture-holders.

3 1 2 Concrete policy shifts leading up the Companies Act of 1973

As far as the regulation of the securities market is concerned, it would seem that South Africa, like England,[102] exhibited a historical preference for minimum direct intervention. What intervention there existed was implemented (at least until 1947)[103] mainly via company law. The unified South African companies regime, having come into being in 1926, remained in essence the same for almost 50

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101 Here Cowen & Gering assert in n 203 at 53 (using the *Randfontein Estates* case as authority) that bearer shares and debentures are negotiable instruments but are *not* constitutive documents in South African law. In respectful disagreement, this may or may not be so – when the debenture also becomes the real security document (the bond) it could very well be characterised as a constitutive document. The relationship between obligations and paper can be described as a continuum, and in terms of documentary intangibles on that continuum a secured debenture in all likelihood also fulfilled a constitutive function in addition to its evidentiary one.

102 See Chapter 2, § 2 2 3.

103 Marking the passage of the first Stock Exchanges Control Act 7 of 1947.

years thereafter. However, aside from smaller amendments, it was subject to two major policy overhauls before developments leading up to 1973 introduced a more fully revised Companies Act.

The first occurred as a result of the Report of the Company Law Commission of 1935-1936.[104] As is clear from the Report, there remained, at this stage, a large-scale reliance on the parallel developments in English company law. They substantially influenced the outcomes of the Report.[105] The Report further noted that from a policy perspective, much of the reform of company law was aimed at improving protective measures for *investors* and *creditors*. The contemporary company law environment had become increasingly encouraging of the public's participation in capital formation, and one in which new methods, not previously accounted for, were being used to raise funds for corporate ventures.[106] Not all of these developments were viewed with approval.

In these matters, the Report stressed the importance and power of publicity as a counter-measure against the exploitation of the public – specifically against the risk of value-overstatement or serious fraud.[107] For potential creditors, the yearly balance sheet (one could probably read into this a broader focus on financial reporting in general, which again echoes the contemporary usages in England)[108] was emphasised as a tool by which financial stability[109] could be evaluated.[110]

Thus a large portion of the Report focused on disclosure (i.e. "publicity") – specifically the prospectus and financial statements.[111] While these elements remain material to the regulation of securities at large, they are not material to the core question at hand. The Report persisted in its deference to private enforcement mechanisms, eschewing the suggestion that the Registrar of Companies ought not only to have oversight, but also control over the issue of a prospectus. As stated:[112]

> "The unavoidable consequence of such a process would be that a prospectus approved by the Registrar would be ascribed a kind of government approval or guarantee of legitimacy."

The Lansdown Report is also significant because it explicitly recognised the importance of extra-legal influences on company practices. First and foremost among the influences discussed was the

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104 U.G. No. 45, 1936 ("the Lansdown Report").
105 Paras 5, 6, and 9-11.
106 Para 12.
107 Para 13 and also generally in paras 57-82.
108 See Chapter 2, § 2 2 3.
109 And implicitly investors' *risk*.
110 U.G. No. 45, 1936 para 13.
111 Para 48 & n 240 & 242.
112 U.G. No. 45, 1936 para 60 [own translation].

impact of the JSE.[113] It is clear that obtaining listing on the JSE was seen as an important objective "for most companies…especially the case for mining and finance companies."[114]

The Report noted the rigour of the process of application to the Exchange Committee for listing and emphasised that this system was principally based on its counterpart at the London Stock Exchange. It ultimately concluded that it was neither appropriate for the Report to inquire as to how the JSE's Committee exercises its powers of oversight, nor necessary to bestow on the JSE any specific statutory competencies (or, conversely, exercise any statutory control over it).[115] This is direct evidence of the laissez-faire, discrete and extra-legal flavour of the formal (exchange) market's regulation, despite explicit recognition of its vital importance in company matters.

Finally, the Report considered the real security arrangements which made debentures so useful at that time.[116] In light of the dicta in *Consolidated Textile Mills*,[117] it would seem that a company was barred under the original 1926 Act from passing a notarial bond over movables in addition to a mortgage bond over immovables, and would have had to, as per the Act, register a mortgage bond encompassing both classes of things. The Report recommended altering the Act so that a notarial bond and a hypothec could be used to bond movables and immovables separately and respectively for the same class of debentures.[118] In making more flexible real security arrangements available, this recommendation seems to support the idea that debt securities' primary role was to reduce transaction costs of corporate borrowing.

These are the important policy positions and changes suggested by the Report.[119]

The next large-scale intervention is found in the interim and final 1948 Reports of the Commission of Inquiry regarding the Amendment of the Companies Act.[120] The relatively short Interim Report is of little value save to re-iterate the importance of the protection of investors and the influence of English company law developments.[121]

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113 Paras 15-18. This serves to underscore the value of the JSE as proxy for the securities market *in toto*.

114 Para 15 [own translation].

115 Paras 16 & 18.

116 See above in § 3 1.

117 See above, § 3 1 1 1.

118 U.G. No. 45, 1936 para 208.

119 Whether these recommendations were implemented, and how, is of less importance here than the policy-thinking of the report, and is not dealt with further here.

120 U.G. 78/48 and U.G. No. 69-1948 respectively ("the Millin Commission" – "interim Report" and "final Report") [own translation].

121 U.G. 78/48 para 1.

Nonetheless, this interim Report does imply a crucial terminological clarification. It is quite obvious that the term "shares" translates into Afrikaans as "*aandele*". It would further seem from the Afrikaans text of the Report that "stocks" translates into "*effekte*", i.e. "…*'n reeks* [fully paid up] *aandele wat in 'n bondel saamgevat is…"*.[122] It seems that in English, the meaning of the term "stock" shifted from denoting specifically share- and debenture-stock (in the technical sense)[123] to all manner of debt and equity *securities*. It was only later that this wider form of the term stock was replaced by the term *securities*. This is illustrated by the later phasing out of the phrase "stock exchange", in favour of "securities exchange" both in England and domestically.

Afrikaans, on the other hand, never moved away from the term "*effekte*". As evidenced by the continued use of the term "*effektebeurs*", its meaning simply shifted from denoting (1) stock in the technical sense, to (2) its wider meaning, and finally to (3) securities. The divergent commercial terminology often found both in English and Afrikaans in their own right, as well as in translation from one to the other, causes difficulty when attempting to be legally precise.

The Final Report of the Commission is slightly meatier and suggested a major overhaul of the Act. From the outset the Commission made it very clear that, much like the Lansdown Report, the developments in English company law substantially, if not overwhelmingly, influenced the Commission's findings and recommendations.[124] Incidentally, between the Lansdown Report and the publication of the findings of the Millin Commission, the number of registered companies in the Union had grown from 7 852 to around 32 000 – with public companies outnumbering private companies more than 3:1.[125]

Its first relevant contribution is in the context of prospectus requirements, principally serving to regulate so-called "stag" speculators. The common law rules of contractual offer and acceptance dictate that a firm offer can be revoked at any time before acceptance.[126] Yet the offer contained in a prospectus, much like an advertisement, is often (depending on its wording and surrounding circumstances)[127] construed as an *invitation to make* an offer. After this preliminary pre-offer, the

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122 Para 16.

123 See § 3 1 1 2; and Chapter 2, § 2 3 2.

124 U.G. No. 62-1948 paras 5-10 – the Committee endeavoured (and in large succeeded) to incorporate as much of the English developments as was possible into their recommendations, placing much reliance on the contributions of the so-called "Cohen Commission" (the Report of the Committee on Company Law Amendment (1945) Cm 6659) which effected a consolidation of the English company law statutory framework in 1947.

125 Para 13.

126 See for example Van der Merwe et al *Contract* 50, § 3.2.3.

127 See also § 3 1 1 1.

subscriber makes the true offer, and the company communicates true acceptance via notice of allotment.[128] At this point, a valid contract (of subscription or allotment) has been concluded.[129]

So-called "stags" made large offers in the hope of driving up the premium at which shares or debentures would be eventually issued, for a profit on disposal. Should such prospects diminish, they would rescind these substantial offers, causing administrative chaos for the issuer, and often interfering with the latter's ability to proceed to allotment on the (ultimately incorrect) supposition that the offer was fully subscribed. The Commission's recommendation was to modify the common law to make the subscriber's offer irrevocable for three days.[130]

The Commission, following similar developments in England, also discussed the matter of the ownership-nominee relationship regarding shares.[131] Here the problem was the potential risk of the use of nominees for non-legitimate purposes. The problem was addressed by suggesting that the relevant Minister be given the authority to investigate the true ownership position regarding shares.[132] This would seem to be the first expression of South Africa's regime of disclosure of beneficial interest holders. Incidentally, it is unclear what the position of the beneficial interest holder (using the term broadly) of a debenture was. Were such a holder not yet in possession of the documents, or not yet listed on the register of debenture holders (such as a very recent cessionary) the relationship between the registered owner and/or holder of the documents and the beneficial interest holder was unclear.

There did not seem to be any explicit recognition that there can be such a nominee relationship in the context of debentures and the extensive registration requirements of secured debentures as well as the overall scheme of the Act did not explicitly authorise a nominee-relationship. However, this is not strictly necessary. The *Randfontein Estates* decision makes it clear that the personal right is viewed as distinct from the documentary instrument.[133] The mere fact that s 27 of the Act – "[t]he company shall not be bound to see to the execution of any trust, whether express, implied, or constructive, in respect of any *share*"[134] – only applied to shares does not seem to detract from this argument.

Further evidence for this view is the wording found in examples of so-called company debentures published in 1926 and 1940, stating that the company is "bound to pay to [blank] of [blank], *or other*

128 U.G. No. 62-1948 para 81.

129 Pretorius et al, *Hahlo's Company Law* 178.

130 U.G. No. 62-1948 para 81.

131 Paras 182-188.

132 Paras 183 & 187.

133 As shown in § 3 1 1 1, as well as this section.

134 Own emphasis. See also Pyemont *Company Law* 54.

the registered holder thereof [*sic*]…"[135] in conjunction with "[t]he registered holder will be deemed exclusively entitled to the benefit of this debenture…" in the terms and conditions typically found on the reverse-side of such debentures.[136] The current legal position, best illustrated in the terms of issue of contemporary sovereign debt securities, seems to put this view beyond dispute.[137] However, it must be added that other debt instruments may be created without such wording, in which case they would not fall within the class of registered securities, and may not even in all cases (as per the outcomes of Chapter 6) fall within the class of securities at all.

This conclusion is further supported by the Report. It suggested extending the powers afforded the Minister to investigate any persons with a real financial interest, including matters relating to debt securities. The suggested clause 96 (to replace the then current s 96) contained explicit mention of debentures.[138]

As in the original Act, both the Lansdown Report and the Millin Commission treat shares and debentures as interchangeable in their analysis of the broader aspects of corporate finance in the Act. An overall impression of increasing confluence of these two instruments by the legislature is created. It would seem that (the specific provisions dealing with debentures in sections 91-94 of the Act notwithstanding) the policy position on corporate financing through securities is characterised by a treatment of debt and equity instruments as *equivalents for some purposes* in the Act.

In sum, the policy perspective leading up to the post-1973 companies regime is one of strong alliance with English principles, an *ad hoc* willingness to deal with the repercussions of new (practice-driven) issues as and when they arise, and a largely laissez-faire approach to securities markets. Moreover, as the securities market became more advanced and active, and debt securities established themselves as prominent financing instruments within the market, the popularity and usefulness of the *stock* concept (the precursor to the *securities* concept) increased. The legislature responded by grouping equities and debentures together – as "shares" and "other interests in the company", but never explicitly as "stocks" – for a multitude of purposes.

More generally, much of the regulation and statutory modification of the common law points to a supportive stance in enhancing corporate borrowers' ability to raise capital, and the market's ability to provide it. This was achieved by further efforts to reduce transaction costs and adjust the administrative and remedial efficiency of debt (and equity) securities, specifically as the market gradually increased in size and sophistication. While prospectus requirements, financial disclosure

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135 Pyemont *Company Law* 219, and Emmet *Company Law* 199.

136 Pyemont *Company Law* 220, and Emmet *Company Law* 200.

137 See Chapter 4, § 4 1, and specifically § 4 1 3.

138 See para 81 of the "Concept Bill" at the end of the Report (U.G. No. 62-1948).

and publicity received the most attention, the policy stance of this era still attributed more importance to enabling capital raising than to considerations of market integrity. In sum, after the passing of the 1926 Act, the legal nature of debentures remained unchanged for almost 50 years.

3 1 3 The beginnings of a conceptual shift: the post-1973 dispensation

Beyond the Millin Commission's Final Report, South Africa's company law and policy stance remained mainly unaltered for more than two further decades. Despite having become a republic in 1961, strong adherence to English law in company law matters persisted.[139] It was only approximately 13 years after the Republic's inception that the:[140]

> "Companies Act 61 of 1973 ("the Act"), result of the labours of the Van Wyk De Vries Commission...effectively cut the umbilical cord between English and South African company law."

This, of course, does not imply that South African company law does not still share much of its maternal jurisdiction's genetic traits.

3 1 3 1 The contributions of the Van Wyk de Vries Commission

The Commission of Enquiry into the Companies Act ("the Commission")[141] preceded the next and by far most significant policy event before the passing of the current Companies Act.[142] The Commission's recommendations and resulting Act amount to much more than the consequence of a political impetus to separate the South African commercial legal framework from English law. The 1926 Act had undergone significant changes, and its internal structure was becoming incoherent. It had retained much of the structural form of its predecessor in the Transvaal (which by 1926 was itself already somewhat antiquated). Despite amendments in 1939,[143] 1942, 1946, 1950, and 1951, as well as 1952,[144] there had been no statutory *consolidation* of these amendments (as there had

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139 Having entrenched fundamental legal constructs such as transferability of interests, limited liability, freely available corporate personality, nominees, holders' registries, and even modern debt securities themselves, to name a few.

140 Pretorius et al *Hahlo's Company Law* (1999) 2.

141 R.P 45/1970.

142 71 of 2008.

143 The result of the Lansdown Commission as discussed above in § 3 1 2.

144 The last mentioned served, belatedly, to implement the recommendations of the Millin Commission as discussed in § 3 1 2.

been throughout the development of English company legislation), resulting in an urgent need for structural reform over and above any substantive overhaul.[145]

From a policy perspective, the Commission's approach was wary (although not dismissive) of English developments. It specifically cited the work of England's Jenkins Committee[146] as useful but not decisive, noting that "[the] past decades have witnessed the emergence of differences between company activities and their underlying concepts in the respective countries." As such, the problem that "our legislation has in certain respects equated the nature and functions of institutions and functionaries in England with institutions and functionaries in South Africa, from which they vastly differ..." forms a crucial part of the Committee's perspective on the state of company law in South Africa at the time.[147]

It has already been shown that South African commercial (and securities market) activities underwent a period of substantial growth and development after the Second World War.[148] The Commission recognised this explicitly,[149] noting specifically large-scale growth in the number of registered companies.[150] From this, a correlative rise in the number of debt and equity instruments issued for the purposes of corporate finance would not be an unreasonable inference to make.

Against this background, the Commission's terms of reference (or, in plainer language, its ambit and objectives) included – as with the Millin Commission before it – the explicit recognition of (1) investor protection, and (2) the public interest in matters of company financing. These two principles presumably overlap to some degree and are widely viewed as fundamental to securities regulation.[151]

A high degree of importance was also attached to the avoidance of unnecessary regulatory conflict between South African company law and that of other jurisdictions. The UK, other Commonwealth countries, the USA, and the Continent (specifically the European Economic Community) are mentioned by name. Further, the Commission regarded cognisance of the rules and requirements of stock exchanges as particularly important for the harmonisation and alignment of the South African

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145 See R.P. 45/1970 at paras 10.1-10.3.

146 Report of the Company Law (Jenkins) Committee (1962) Cm 1749.

147 R.P. 45/1970 paras 9.03-9.04.

148 See Chapter 2, § 2 3 2.

149 R.P. 45/1970 para 9.01.

150 Para 3.02.

151 Paras 2.01 & 12.01.

legal dispensation with these jurisdictions,[152] specifically against the backdrop of an increasingly globalised international securities marketplace.

Nonetheless, the character of the South African regulatory context was left largely unchanged, and the Commission's approach to the role of government remained a tempered one. The recommendations regarding the functions of the Registrar appositely illustrate this. According to the Report, "powers of control over companies" did not, and should not, vest in this functionary. Further, the Office of the Registrar was definitively not regarded as analogous or equivalent to a regulatory body such as the United States' SEC.[153] A perfect summation of the Commission's position is found in the statement that "any control over company activity by the State should be *confined to the exigencies of public interest.*"[154]

With this as background, the Commission addressed the content of the proposed legislation.

It has already been observed that a partial, implicit conflation of shares and debentures for a number of purposes is evident in the 1926 Act. However, from the 1973 Act onwards, this is explicitly done through the use of the *securities* concept to regulate these instruments as equivalents in certain instances, further entrenching this tendency.[155] An important first step in this trend is the Commission's noteworthy recommendation of a partial integration of pre-existing stock exchange law by insertion into the draft Bill. This scheme of integration has become one of the definitive aspects of the relationship between company law and securities law.

Specifically, the recommendation dealt with the transfer of listed securities, where a specialist piece of regulatory legislation was already in place. In detail, the Commission proposed[156] that "*all* the provisions of the Securities Transfer Act except those of a purely fiscal nature, be incorporated into the Companies Act".[157] At the time, this was motivated by (1) the fact that the Commission viewed the transfer of shares fundamentally as a company law matter; (2) the risk of the fragmentation of company law into specialised discrete pieces of legislation, with potentially conflicting objectives; (3)

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152 Para 12.03.

153 Para 13.07.

154 Para 13.08 [own emphasis].

155 See § 3 1 2.

156 For the Commission's position, see R.P. 45/1970 para 35.06 & recommendation (58) [own emphasis].

157 The Act is 69 of 1965, and the definition read:

> "'security' means any fully paid up share, stock, debenture, debenture stock, loan stock, unit in a unit portfolio or other security, other than a bearer security, which is included in the list of stocks and shares referred to in paragraph *(a)* of sub-section (1) of section *nine* of the Stock Exchanges Control Act, 1947 (Act 7 of 1947), that may be dealt in on a stock exchange licensed under section *six* of that Act, and includes any right of option to acquire such a security, whether fully paid up or not, included in the said list".

It must be noted that almost immediately after the passage of the new Act, s 134 ("Definitions for the purpose of transfer of listed securities") was amended by Act 76 of 1974, so that the operative definition came from s 1 of the Stock Exchanges Control Act of 1947.

an opposition to trends in other jurisdictions moving all share-related matters out of the purview of company law; and (4) the fact that South Africa had (and presumably would continue to have) only one stock exchange.[158]

It could well be that these concerns were afforded too much weight. However, regardless of its merits, the Commission's chosen response caused its own issues. The stock exchange law[159] in force at this time was mainly, if not exclusively, concerned with equities. This perfectly accords with the *zeitgeist*, emanating from the composition of the domestic securities market. Nonetheless the law as it stood did contain a broader securities concept,[160] framed (1) in far wider terms than equities alone, and (2) slightly differently in each Act dealing with securities. In grafting listed securities' transfer arrangements from the Securities Transfer Act[161] onto company law, the proposed companies legislation would assimilate the securities concept associated with the Act from which it was incorporated.[162] Two observations regarding this process show that its unqualified, unrefined assimilation into company law held the potential to be problematic.[163]

First, stock exchange legislation did not *in principle or by definition* distinguish between debt instruments and equity instruments, treating them both merely as "securities". Over and above its implicit focus on equities, the Commission's efforts are explicitly directed at the transfer of *shares* in company law.[164] As a result of using the securities concept, all legal rules hinging on this concept (intended primarily for share transactions) would be equally applicable to debt securities, without due consideration of the differences between the two types of securities, or any unintended consequences this may have. This first issue may be termed a *share-centricity* in the use of, and approach to, the securities concept at this stage in the development of the law.

Second, discrete pieces of legislation rarely share the same subject-matter, objectives or policy foundations. Even if two statutes deal, for instance, with the same legal phenomenon (for example financial instruments), they are unlikely to deal with the same *aspects* of that phenomenon. They will

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158 R.P. 45/1970 paras 35.01-35.05.

159 Including most notably the Stock Exchange Control Act and the Securities Transfer Act 69 of 1965.

160 "Securities" as a general concept exists, of course, separately from any given statute. However, as a legal term, as a result of the nature of South African law's mixed legal heritage and the statutory supremacy of its pre-Constitutional structure, it mainly emerges from legislation. It seemingly first appeared in legislation in 1911 in the Public Debt Commissioners Act 18 of 1911 (and its later amendment). It reappears in original versions of the Finance Act 64 of 1934, the Insurance Act 27 of 1943, and incidentally in other legislation. However, most importantly, and in terms of the current context, it was found in the Securities Transfer Act and the Stock Exchanges Control Act of 1947. This issue of delineating the securities concept accurately is the dominant theme of Chapter 6, where it is dealt with in detail.

161 69 of 1965. Again, as noted above, shortly thereafter the referenced definition changed to the one from the Stock Exchanges Control Act.

162 As evidenced in s 134-140 of the final Act, as well as s 91A & 140A, which were added later.

163 These problems will be dealt with in more detail in the next section, mainly in terms of the 1973 Act itself.

164 R.P. 45/1970 para 35.

inevitably be enacted for different reasons, deal with different aspects of law and reality, and be shaped by different policy considerations. In other words, they will be *purposively different*, and the constructs they may share (for instance the security concept) must be approached in teleologically distinct ways. For that reason, they will also often define shared terms, such as "securities", slightly differently. On the other hand, a Bill or an Act which assimilates a concept from another piece of legislation without qualification or refinement does so not only in its word but also in its spirit, because jurists typically turn to the original legislation, and related judicial and academic authority, for interpretive guidance. This runs a number of risks, including definitional ambit risk,[165] drafting risk,[166] interpretive risk,[167] and conceptual risk.[168] This second issue may be broadly termed *purposive incongruity.*

In the present context – the transfer of listed securities – the securities concept was *nominally and enumeratively* defined (i.e. with reference to a *list* of the *names* of all the instruments to be considered securities for the purposes of the Act) in both in the Securities Transfer Act and thereafter the Stock Exchanges Control Act. Yet even a comparison of the definitions of the latter two Acts shows notable differences.[169] The materialisation of the risks posed by share-centricity and purposive incongruity is dealt with in the next section.

A second notable aspect of the Report is the role of the JSE in matters of regulation and oversight. This function is endorsed by the Commission in several areas within its report. In the Supplementary Report and Draft Bill[170] it is stated that the stock exchange serves as a valuable mechanism through

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165 The definition may be appropriate in its original context but is too wide or narrow in this secondary context, and the definition may rely on pronouncements by a duly empowered functionary, which may change over time. A perfect example is found in the definition of "securities" in the Securities Transfer Act, which includes a reference to s 9 of the Stock Exchange Control Act as it then was, wherein the "committee of a licensed exchange" was empowered to keep a list "of the stocks and shares which may be dealt in on the stock exchange". This list was, no doubt, subject to change over time, which would have had implications for its secondary *company law* context through its use in the Bill and the first version of the Act (were it not amended in 1974 to refer to the definition of the then-operative Stock Exchanges Control Act, as has been noted).

166 For instance the concept may change through amendment in its original context, for reasons that may not necessarily apply to its secondary context, or an amendment of its secondary context may not take into consideration the full implications that the original definition has for that amendment – as is argued in § 3 2, this is the case with s 91A.

167 Similar to drafting problems, it may lead to subsequent interpretive issues – for example, as the context of the originating legislation changes, the interpretation of the concept may change, importing this change into the assimilating legislation when it may not be appropriate. Alternatively, the secondary context may shift, but a corresponding and necessary change in the interpretation of the concept may not be possible as its interpretation is bound to the interpretative views on the originating legislation.

168 Quite simply that the version of the concept found in the originating legislation is not conceptually appropriate and requires instead a new, more precisely and appropriately formulated a version of its own. For instance, Act A (dealing with road traffic) may choose to define "transportation vehicle" widely, including bicycles, skateboards and motorised vehicles. Act B (dealing with the manufacturing standards of transportation vehicles) may import this definition, and inappropriately subject non-motorised vehicles, such as bicycles, to the same stringent manufacturing standards of their motorised counterparts without a sound policy-basis to do so. Instead, Act B should provide its own, more refined definition which only refers to motorised vehicles.

169 See s 1 of both Acts as well as s 9 of the original unamended Stock Exchanges Control Act of 1947.

170 R.P. 31/1972.

which the *contents* of a Companies Act can be enforced.[171] The Commission again stresses that the law relating to companies and the rules and requirements of the stock exchange must as far as possible be harmonised.[172] Protecting the general populace as current, notional, and prospective investors is a crucial point of intersection between securities and company regulation.[173]

Before 2004,[174] the JSE wielded more than administrative power, and was central to the regulation of securities – even in the enforcement of aspects of the companies regime. Even after the Securities Services Act handed regulatory power to the Financial Services Board (which has now become the Financial Sector Conduct Authority, or the "FSCA"), this did not change the regulatory reality substantially. The FSB traditionally devolved most of its regulatory power back to the JSE. Thus, the JSE is regarded as a self-regulatory organisation ("SRO") which was *accountable to*, but to a far lesser extent *regulated by*, the FSB itself. More recently the Financial Sector Regulation Act and the introduction of a twin peaks model of prudential and conduct authorities appears to have made the regulatory role of the FSCA far stronger.[175]

Turning finally to debentures themselves, it is noteworthy that neither the Commission's Final Report nor its Supplementary Report contains any special section dealing with debentures. The suggested changes to the legal framework governing these instruments are taken up in the Draft Bill section of the latter. The draft itself contains perfunctory glossary notes on some of the proposed changes. Despite this lack of attention, the Commission states that:[176]

> "[t]he drafting of the provisions has been revised considerably; it seems to be a part of the Act which has been somewhat neglected but it has gained greater importance in light of the present prevalence of issues of debentures and notes."

The Commission did not move away from the 1926 Act's approach of prescribing the procedures by which the different bonds were to be registered. However, these were slightly simplified, and the pledge of incorporeal rights was included in the list of recognised forms of real security that

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171 Para 78.04.

172 Para 78.03.

173 Para 78.06.

174 The year the Securities Services Act was passed – see Chapter 2, § 2 3 2.

175 Act 9 of 2017.
See also, for instance, International Monetary Fund "South Africa: Detailed Assessment of Implementation on IOSCO Principles—Securities Markets" (2010), available at <https://www.imf.org/external/pubs/ft/scr/2010/cr10355.pdf> (accessed 31-01-2021).

176 R.P. 31/1972 para 90.

debentures could be backed by.[177] The recording of such pledges in the company's internal register of bonds was also concomitantly addressed.[178]

As far as certification and transfer is concerned, the most important suggested changes were as follows. The "terms of the debenture"[179] had to be stated on the debenture certificate, and the certificate should be signed in the same manner as a share certificate.[180] The transfer of debentures without a "valid instrument of transfer" was prohibited,[181] and the recommendations made explicit that the certificate served as evidence of title.[182]

That these arrangements were foremost in the Commission's mind demonstrates a gradual shift in perspective towards the importance of the *transfer* arrangements regarding debt (and equity) instruments. This is in contrast to the historical focus on real security arrangements. The attention afforded to the transfer of securities reflects the changing role of debt securities, steadily becoming more important as trading and investment instruments, over and above their traditional function of reducing transaction costs in corporate borrowing schemes. Additionally, the above further illustrates the observation that debentures and equities were viewed as separate but equal (as securities) *not only for the purposes of securities and exchange law, but also company law.*

Following this thinking, the Commission's most pivotal recommendation regarding debt securities was the suggestion of a new definition (as the old Act did not contain one) for a debenture. This definition, close to the contemporary definition in English company law legislation,[183] read:

> "'Debenture' includes debenture stock, bonds, notes, and any other securities or debt securities of a company, whether secured or not."

The last section of the definition, dealing with real security, is the least important. Whilst the Commission stated that explicitly qualifying debentures with the terms "secured" or "unsecured" was of some significance,[184] this aspect of the suggested provision was not kept on in the final draft. To

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177 Paras 91 & 92. This was, most likely, in response to the growing importance of securities' *collateral* function in the broader financial markets – see for instance Benjamin *Interests in Securities* (2000) 7 & 79-95.

178 Para 95.

179 A problematic phrase, as the terms of a loan contract underlying the debenture and the terms of the debenture itself are not necessarily the same – see below, as well as Chapter 4, § 4 2.

180 R.P. 31/1972 94.

181 Para 97.

182 Para 94. "Title" is also a problematic word, dealt with in great detail in Chapter 4, § 4 1 and Chapter 5, § 5 1 3.

183 Section 744 of the English Companies Act, 1989 – see LCB Gower *Modern Principles of Company Law* 5 ed (1992) 378-380 generally, and n 23 where it is noted that the definition "has remained substantially unchanged since the 1929 Act."

184 R.P. 31/1972 93-94.

understand the impact of the change the definition brought about, regard must be had to the resultant Act[185] itself.

3 1 3 2 The 1973 Act and the ascendancy of the securities concept

The 1973 Act, widely regarded as an excellent piece of legislation, explicitly introduced the securities concept into company law. It did so in two ways: first through the use of a general securities concept (for instance in s 1's definition of debenture); second by incorporating the specific securities concept found in s 1 of the Stock Exchanges Control Act 7 of 1947 (specifically into s 134 and later s 91A and 440A).

In the preceding section it was argued that the risks of share-centricity and (in cases where a securities definition is assimilated from one act into another) purposive incongruity have the potential to limit the efficacy of an act. As will become clear throughout this section and the next, a third overarching risk can also be identified. In short, it is caused by a disconcerting lack of legal certainty regarding the precise *legal* meaning of the word securities.

Distinguishing securities from other financial instruments is premised upon the ability to classify (and thereby identify) particular instruments *as securities or not*. Uncertainty regarding the legal meaning of the term securities makes it difficult to make this classification consistently, which has a number of adverse consequences. First, many legal rules apply based on whether an instrument is a security or not. Inconsistent classification can lead to incorrect identification, which may cause the law to be applied inappropriately or ineffectively in certain (hard) cases. Second, this kind of legal uncertainty increases both compliance costs and risks, with commercial inefficiency and a possible chilling effect in financial innovation as consequence. Third, legal uncertainty also hampers regulators' capabilities to effectively intervene where necessary. The consequences of this uncertainty will be referred to as "application risk".

In this section the ascendancy of the securities concept as the primary determinant for the classification of companies' debt instruments will be outlined. Having done so, its appropriateness and effectiveness can be discussed. That is the topic of the next section, which includes a discussion of these three identified categories of risk. With the exception of the provisions dealing with uncertificated securities (or unless indicated otherwise) the most recent version of the 1973 Act will be referred to.

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[185] 61 of 1973.

To understand why the securities concept had become fundamental to debentures in the 1973 Act, the Act's definition must be properly understood. The definition of "debenture" in the Act (virtually identical to the contemporary English equivalent) read:[186]

> "'debenture' includes debenture stock, debenture bonds and any other securities of a company, whether constituting a charge on the assets of the company or not…"

As is clear, the legislated definition was very similar to the definition suggested by the Committee. It followed the 1926 Act in using an "includes…" formulation. Thus it can be characterised as both nominal (referring to already established instruments by name) and enumerative (listing a number of these established instruments), rather than substantive (in the sense of providing abstract characteristics or guidelines to test a given instrument against, of which an excellent example is the definition of "derivatives" in s 1 of the Financial Markets Act).[187]

However, the definitional similarities between the two regimes end there. The key to this observation is the phrase "any other securities", which represents a major (perhaps unconscious) shift in the legislature's approach. Yet the significance of this shift is not obvious at first glance.

The 1926 Act's definition did not make use of the word securities. Instead, it relied on case law, as informed by the definition of the repealed Company Debentures Act, for its (limited) substantive content, founded centrally on the notion of a "written acknowledgement of debt".[188] The 1973 Act, on the other hand, utilised the securities concept to demarcate (or circumscribe) the *limits* of what may or may not be considered debentures for its purposes. For this reason, under the new regime, it is argued that being a security had become the foundational attribute of a debenture. Why?

The Act did not define the securities concept save in s 134 (for the purposes of s 135-138 and 140 – "listed shares or interests"; and later also in s 91A and s 440A) where it incorporated the definition in the Stock Exchanges Control Act.[189] The latter Act, as amended by the Stock Exchange Control Amendment Act,[190] defined "securities" in s 1 as follows:

> "'securities' includes stocks, shares, debentures (whether issued by the State or a company having a share capital or any other body corporate or association of persons), notes, units of stock issued in place of shares, and options on stocks or shares or on such debentures, notes or units, and rights thereto, but does

186 Section 1 of the Companies Act 61 of 1973; the English position has been dealt with in the preceding section.

187 19 of 2012, which reads "any- (a) financial instrument; or (b) contract, that creates rights and obligations and whose value depends on or is derived from the value of one or more underlying asset, rate or index, on a measure of economic value or on a default event".

188 See § 3 1 1 2.

189 7 of 1947 as amended. This discussion of the Companies Act excludes the definition later found in s 91A.

190 86 of 1971 – the product of the "Broome Commission", R.P. 47/1965.

> not include [shares in a private company and stocks or shares, or options on them, in a public company with restrictions on transfer]…"

This very specific (incorporated) definition was obviously of very limited application within the overall framework of the Companies Act, dealing only with the transfer of listed securities. This singular exception notwithstanding, one can return to the s 1 definition of "debenture" and make the following observation. In order to know whether a given borrowing contract was in fact a debenture for the purposes of the Act, some meaning would at least have to be given to (1) "debenture stock", (2) "debenture bonds", and (3) "any other securities of a company". Each of these will be considered in turn.

"Debenture stock" is not problematic. Debenture stock is not in essence as similar to debentures as the naming convention makes it appear.[191] Here an issuing company would create a single debt in favour of a special purpose vehicle (almost always a trust) and issue debenture stock certificates to the ultimate holders of the stock. Thus, the holders of these certificates would become jointly participating creditors in the entirety of the stock (the loan), proportional to the amount of stock taken up. It follows that unlike debenture holders, debenture stock holders did not receive independent and individualised rights against the company. The company undertook to perform toward the trustee or trustees, which also reduced the holders' remedial options, as indirect participants to the loan, to bringing action in furtherance of their interests against such trustees rather than the company.[192]

In the case of "debenture bonds", the problem is limited. Before the inclusion of s 91A, s 96(1) of the Act made it clear that all debentures – like shares – must have certificates. The import of the term debenture *bond*, however, specifically implied real security. The Act (in form and function similar to its predecessor) prescribed in detail how to effect such security and what its consequences would be[193] – therefore the logic of the 1926 regime as set out above presumably still applied. Nonetheless, for such a borrowing contract to have been considered a debenture bond, and not merely a secured loan, it would still have to be established that the underlying contract was a secured *debenture* issued to the special purpose vehicle.

This neatly narrows down the issue to the meaning of "debenture" under the 1973 Act. Under the previous Act, the contents of the term debenture was left to the common law – a written acknowledgement of indebtedness in the form of a certificate received upon allotment, coupled with entry on a register.[194] It could be secured, and executed under a bond (singular or composite,

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191 See § 3 1 1 2 above.

192 See Blackman et al *Commentary* 5-328.

193 Section 117-121 of the Companies Act 61 of 1973.

194 See s 89(1) of the Companies Act 46 of 1926 for certification.

depending on the nature of the property over which the bond operated – movable, immovable, or both) in accordance with the Act's arrangements for such execution. As shown above,[195] this would activate certain statutory consequences. It could also be unsecured, but by virtue of being certificated *as a debenture* would also activate certain statutory consequences. Had this changed with the passage of the Companies Act of 1973?

Blackman et al, on the 1973 Act, describe a debenture as "a written acknowledgement of debt, irrespective of its form, executed by the company, which may (but need not) include terms providing for the indebtedness to be secured by a charge over the property of the company."[196] As a unique type of creditor, the terms on which the debt security had been issued, in conjunction with applicable statutory provisions (such as the Companies Act), determined the holder's rights.[197]

Yet the core question is not descriptive, it is *classificatory*. The Blackman description could just as easily describe an ordinary written contract of debt, were it not evidently set out in the context of debentures. Which company borrowing contracts could be classified as debentures, and which not? The answer lies in the plenary, catchall part of the provision – "any other securities". To understand this, it must be read in conjunction with the word "includes". When so read, the definition had three fundamental implications.

First, it indicated that the list was not intended to be a *numerus clausus*. This was a sound policy position, in keeping with the fact that company law must always reckon with rapid and innovative developments in the realm of finance and financial instruments. Second, "other securities" strongly appears to require a *eiusdem generis* interpretation.[198] This means that in order to be classified as a debenture, the instrument in question at least had to be founded upon a debtor-creditor relationship between the company and the counter-party. Third, and most importantly, by stating that "'debenture' *includes*...[financial instrument A], [financial instrument B]…and any *other* securities", an implicit circumscription of what could and could not be a debenture was built into the Act. The logic is as follows. First, "other" implied that financial instruments A and B were also securities. Second, any debt instrument other than A or B that was also classifiable as a security, was inherently a debenture.

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195 See § 3 1 1 2.

196 Blackman et al *Commentary* 5-327. This description is often accompanied, in South African literature, with reference to the classical compendium of English, South African, and Australasian cases: *Edmonds v Blaina Furnaces Co* (1887) 36 ChD 215; *British India Steam Navigation Co v Inland Revenue Commissioners* (1881) 7 QBD 165 172–3; *Levy v Abercorris Slate & Slab Co* (1887) 37 ChD 260; *Lemon v Austin Friars Investment Trust Ltd* [1926] Ch 1 17; [1925] All ER Rep 255 (CA); *R v Findlater* [1939] 1 All ER 82 85 (CA); *Knightsbridge Estates Trust Ltd v Byrne* [1940] AC 613 621–3; [1940] 2 All ER 401 405–6 (HL); *Handevel Pty Ltd v Comptroller of Stamps* (1985) 10 ACLR 207 218 (HC of A); *Austral Mining Construction Pty Ltd v NZI Capital Corporation Ltd* (1991) 4 ACSR 57 58 SC (Qld); and *Re SH & Co (Realisations) 1990 Ltd* [1993] BCLC 1309 1317–18.

197 Blackman et al *Commentary* 5-327.

198 Blackman et al *Commentary* 5-328.

Thus, *all debentures were considered securities,* but far more crucially *all debt securities would have to be considered debentures.*[199] This is uncontentious, as the word "other" demonstrates that all the named instruments were viewed as securities inherently. Conversely, if a debt instrument or borrowing contract was not a security, it could not be a debenture for the purposes of the 1973 Act. The implicit circumscription (and thus limitation) of the meaning of debenture therefore had to be determined by the meaning of a "security". It cannot be the other way around – as debenture was the term being defined, it cannot function to describe any aspect of its own definition without the logic of the definition becoming circular.

These three implications can be summed up as follows: *any* contractual arrangement could be classified as a debenture, if: (1) its essence was the incurrence of debt by the company, and (2) the arrangement created a legal interest held by the counter-party and effective against the company which was also (classifiable as) a security.

However it is important to note that, contrary to this conclusion, Blackman et al state that "[the statutory definition of debenture], then, is not a definition of 'debenture', rather *it assumes that 'debenture' has an ordinary meaning,* and merely extends or confirms that meaning to include debenture stock, debenture bonds and any other securities of the company…".[200]

With respect to the authors, debenture may have had a semblance of an ordinary meaning, but that meaning was definitely neither certain nor ascertainable. This remains the case. Furthermore, the commercial reality ascribes little to no importance to the term. The current Companies Act has replaced it with "debt instrument", and the securities markets of today deal overwhelmingly in bonds and notes, not in debentures. Lastly, the ordinary meaning of debenture is not, as proposed in the above construction of the definition, pivotal in any way. This leads to a more fundamental terminological point regarding the importance of the securities concept vis-à-vis the debenture concept.

Whatever terminology is decided upon by the law, it must not be forgotten that at its core, the law is an abstraction of reality, seeking to bring that reality to order.[201] In this way, one manner in which to

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199 A Milne, C Nathan, KL Smith & PM Meskin in *Henochsberg on the Companies Act 61 of 1973* 3 ed (1975) argue at 218 that a "security" generally refers to an asset, and that – since a debenture constitutes a liability from the company's perspective – it generally means a "secured obligation" viewed from the perspective of the holder. However they further argue that since debentures can also be unsecured, it is more likely that security merely refers to "…what is included in the term debenture [which] would also have its general meaning of an acknowledgement of debt". In other words, the term security really means any type of debenture, usually one which is secured. This, clearly, is a circular argument, and does not account for the points raised below. See also Blackman et al *Commentary* 5-328, n 4.

200 Blackman et al *Commentary* 5-326. This is similar to the problem encountered in A Milne et al *Henochsberg 1973* 218, as above.

201 See for instance a very useful, if slightly simplified, exposition of this in L Du Plessis *An Introduction to Law* 3 ed (1999) 1-4.

describe the problem may be as follows. The law uses abstract signifiers (words) to describe the concrete aspects of reality it wishes to regulate – the signified. The function of a signifier in this context is to serve as an "interface"[202] between the law and reality, facilitating the former's application to the latter.

The term debenture appears, now, to be a weak signifier with which to legally regulate the commercial phenomena it seeks to signify, whilst *security* represents a stronger, more robust signifier and therefore interface. This is increasingly reflected in the terminology of the 1973 Act and even more so the 2008 Companies Act.[203] In interpreting these Acts, understanding the meaning of the signifier "securities" very precisely is the only means by which to deal with the applicable statutory definitions and their consequences, with any acceptable degree of legal certainty. Although nothing fundamental turns on this theoretical framing of the problem, it is a helpful way in which to understand the terminology problem as a key issue in securities law.[204]

The "beginnings of a conceptual shift" proposed above is that, at least from a legal perspective, the change in terminology brought about a deeper change in the foundational attributes of a debenture. This may have been because, commercially, this change had already begun emerging organically. As seen, under the previous regime a debenture's prime attribute was that it was a written acknowledgement of indebtedness – i.e. a separate documentary instrument, accessory to the debt and imbued with its own unique statutory consequences. Under the new regime the operative word remained "debenture", but its meaning had been altered.

The insertion of the (undefined) term "securities" as the pivotal definitional element of the definition of a debenture meant that from this point forward a debenture was, in fact, any company debt *security*. This shift had a profound impact on the legal nature of a debenture. The securities concept denoted (and still denotes) a more a holistic construct than the pre-1973 debenture concept. It includes both the formal *instrument* dimension of certification and registration of holdership *and* the substantive *patrimonial* dimension of the underlying contractual rights. It is thus argued that the legal

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202 The term interface is defined by the Oxford Dictionary as "[a] point where two systems, subjects, organizations, etc. meet and interact, [for example] '*the **interface** between accountancy and the law'*…" – Oxford Dictionary "Interface" <www.oxforddictionaries.com/definition/english/interface> (accessed 25-01-2021).

Here the first system in question is the *reality* of the financial system, whereas the second is the *abstracted* system of law and regulation of that first system.

203 Explicit recognition of this is found specifically in s 43 of the 2008 Companies Act, reading "'debt instrument' – includes any *securities* other than the shares of the company, *irrespective of whether or not issued in terms of a security document*…" whilst "[a] "security document" includes any document by which a debt instrument is offered or proposed to be offered, embodying the terms and conditions of the debt instrument including, but not limited to, a trust deed or certificate" [own emphasis], bringing this conceptual shift to full fruition.

204 This issue is dealt with fully in Chapter 6.

meaning of debenture and the legal meaning of debt security were not exactly the same, with the latter signifying not only the accessory (then documentary) instrument but also the debt itself.[205]

As soon as the attribute of being *securities* became foundational, the historic understanding of debentures as separate and accessory documentary instruments founded upon a debt needed to be discarded in favour of a conceptually integrated view of debentures, where the debt and the instrument are conflated into a single financial product. The meaning of debenture was changing, and this process culminates in the effective removal of the word as an operative term by s 43 the 2008 Act. In this new regime, the securities concept claims full primacy.

3 1 3 3 The securities concept in the 1973 Act: appropriate and effective?

The previous section demonstrates the ascendancy of the securities concept in company law, shows its centrality to classifying (and thereby identifying) company debt securities, and illustrates the impact of this on the meaning, and nature, of a debenture under the 1973 Act. This section deals with the appropriateness and effectiveness of the legislature's use of the concept.

From a legal-historical perspective, the securities concept seems to be a product of commerce. Its inception lies in the development of sophisticated exchanges, whose increasing importance gradually redefined the terms, concepts and practices of corporate and government finance. Most importantly, the exchange and trading industry began increasingly to rely on the term securities to refer to a number of the various financial instruments in use at that time. This was an international trend, with the USA, the UK, and the Continent leading from the front, and South Africa following suit.[206]

This terminological shift[207] had a profound impact on the domestic legislature's approach to stock exchange law, which in turn markedly influenced company law.[208] This is despite the more typical trend of company law principles exerting influence on securities law. Thus a legal-historic analysis of the securities concept must begin with the use of "securities" as a regulatory signifier in exchange- and trading-legislation. Then its subsequent emergence in company law as a seemingly free-standing concept (understood to have inherent substantive meaning) can be addressed.

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205 See Chapter 4, § 4 2 for a thorough discussion of this issue.

206 See Chapter 2 – § 2 1, § 2 2 3, § 2 3 1; as well as § 3 1 3 2 above.

207 See § 3 1 2, and specially § 3 1 3 1.

208 See § 3 1 and § 3 2 2 below, as well as Chapter 4, § 4 1 1.

The securities concept is not *substantively* defined in any legislation, past or present.[209] There is also no body of common law (or statutory common law) on which to draw for a methodology for classifying and identifying securities, or with which to differentiate in all instances securities from other financial instruments or products. This dearth of jurisprudence is addressed more directly and in more detail in the following (analytical-systemic) three chapters.

However, a lack of jurisprudence does not automatically imply that the legal regime is inadequate. Therefore a critique of the then-contemporary legal use of this concept in company law must be broken down into three questions: (1) was the use of a nominal, enumerative definitional approach to securities appropriate and effective in its originating context, i.e. exchange- and trading-legislation?; (2) did the concept develop any substantive content through such use?; and (3) was the subsequent integration of the concept into company law equally appropriate and effective? These questions can be answered with relative ease.

The first question rests on the success of the Stock Exchanges Control Act. The answer is certainly in the affirmative, for a number of reasons. First, as stated, the term securities originated in commercial practice as a means with which to group the various debt and equity instruments that traded on the world's prominent exchanges. For the (predominantly private and peer-based) regulation of trading and exchange activities, the exchange platform and its actors were quite obviously of primary concern. For these role-players, it was more important to be able to refer to traded instruments as distinct from non-traded instruments or instruments that traded elsewhere. Internally distinguishing debt from equity was not needed, and a blanket approach sufficed, specifically after the JSE began to develop specific trading infrastructure for debt securities. Thus, to have used the same term to group those instruments for the purpose of regulating such commercial practices was a sound and logical point of departure.

It follows that from the perspective of stock exchange law, there was no need to differentiate debt securities from equities. A bird's eye view of the architecture of the Stock Exchanges Control Act (and even the consolidated Securities Services Act of 2004) confirms this. Exchange-traded instruments shared the same market players (such as brokers and underwriters), the same method of transfer (delivery in quasi-negotiable form, together with a "valid instrument of transfer"),[210] broadly similar trading methods, and the same trading infrastructure (including, even for a short time *after* the passage of the 1973 Companies Act, the same trading-floor).[211] Also, whilst it could be argued that the risks inherent in these instruments were not similarly analogous, this is a function of the instrument and not the exchange, and thus does not detract from the argument. Hence, to refer to

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209 This issue is the main focus of Chapter 6.

210 See § 3 2 below.

211 See Chapter 2, § 2 3 2 – before the opening of the Gilts Trading Floor at the JSE.

them as one group of separate-but-equal instruments in this context remained entirely appropriate and effective for the regulatory outcomes of the Act.

Second, domestically, there was only one exchange at this stage – the JSE. As evidenced by the Van Wyk-De Vries Report, this was not perceived as likely to change. The JSE was primarily self-regulated,[212] controlling and exercising near-sole oversight over what was listed, and how.[213] It is not surprising, therefore, to find that a reading of the Stock Exchanges Control Act also confirms that it was enacted to enhance, rather than to curb or oversee, the JSE's regulatory powers. Within this relationship between government and the JSE, there was no need for Parliament to dictate to the JSE what could and could not be considered a security – the latter (as the prime regulator) was in a far better position to do this through its own processes.

Here something further must also be said of the nature of the JSE. It is established that the JSE is not a statutory body, merely one operating under a statutory licence, much like a bank or an insurance company.[214] In the pre-Constitutional, common law system of administrative law the courts were afforded limited powers of review, and the JSE's regulatory actions were reviewable on the basis of two specific grounds.

First were grounds built into the Stock Exchange Control Act itself, such as in s 10(3).[215] Second, a number of rulings[216] had confirmed a general principle that certain technically non-public bodies or associations were subject to administrative law principles because they operate in the public interest. On the basis of a concomitant public duty, their conduct could be reviewable in terms of administrative law. The JSE is such a body.[217] This second basis for review included "gross irregularity or clear illegality in the performance of a duty imposed by the Legislature".[218] As an aside, the current post-Constitutional regime under the Promotion of Administrative Justice Act[219] provides for a more general, expansive and accessible framework for administrative review of bodies or

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212 See Chapter 2, § 2 2 3, and § 2 3.

213 Thus, the JSE *determined through listing* a certain investment instrument that it is in fact a security. The definition of security found in the Stock Exchanges Control Act of 1947 makes reference to s 9(1)(a) of the Act, which allowed a licensed exchange to make administrative determinations as to listing of instruments, which would then be considered securities as per the definition in s 1.

Currently, although s 1 *v.* "securities" of the Financial Markets Act 19 of 2012 provides exchanges with less administrative leeway, the registrar may still in terms of ss (d) make determinations classifying instruments similar to those found in the rest of the definition as "securities" for the purposes of the Act.

214 *Herbert Porter and Co Ltd and Another v Johannesburg Stock Exchange* 1974 (4) SA 781 (W) 791B-G.

215 See the discussion in *Dawnlaan Beleggings (Edms) Bpk. v Johannesburg Stock Exchange and Others* 1983 (3) SA 344 (W) 361A-D.

216 Most notably *Johannesburg Consolidated Investment Co v Johannesburg Town Council* 1903 TS 111, specifically at 115; and *Loxton v Kenhardt Liquor Licensing Board* 1942 AD 275, specifically at 309.

217 *Dawnlaan Beleggings (Edms) Bpk. v Johannesburg Stock Exchange and Others* 1983 (3) SA 344 (W) 361E-365B.

218 363A-G.

219 3 of 2000.

associations operating in the public interest. Thus, the JSE was, and remains, at least subject to some administrative law oversight (which would not be the case for an ordinary public company), further contributing to the effectiveness and stability of the now increasingly stringent regulatory paradigm.

Third, this nominal and enumerative approach was contingent upon the ability, in cases of dispute or uncertainty, to identify a particular instrument as being one of those listed in the definition in the Stock Exchanges Control Act (i.e. as being part of the class "securities") *through consulting other sources*. The Act's definition relied on other subsidiary definitions (of the instruments named) from other areas of law or from commercial practice itself. In the case of equities, for instance, the Companies Act of 1973 described shares in adequate substantive terms, and the common law and academic authorities were also clear and comprehensive.[220]

For debentures, this was not the case. Yet, crucially, it was not of much consequence until the late 1980s. The securities market was still overwhelmingly dominated by equities and options. Modern financial instruments, such as hybrid securities, swaps or the asset-backed securities created through securitisation techniques were not yet in use. Thus, for practical reasons the inability to similarly identify debt securities with acceptable accuracy through recourse to other sources remained an unexplored issue.

In conclusion, the answer to this first question is that the use of the securities concept, despite the legal uncertainty regarding debentures and perhaps other similar financial instruments, was in all likelihood both appropriate and effective in the stock exchange context.

The second question is whether the concept, having found its way into law, developed any meaningful substantive content. The short answer is that it had not. It is trite to state that a share is a security. The issue of whether options to take up these securities are themselves securities is left for Chapter 6. As has become clear from the above, debentures are certainly also securities. However, it appears to be more appropriate to use the term "debt security" and do away with the older and weaker signifiers such as "debenture" or "bond". When considering hybrid and other financial instruments such as futures, swaps, or other derivatives, the issue becomes more complex, and this issue again falls to Chapter 6 to deal with in detail.

It suffices to say here that other than the nominal and enumerative definitions found in statute (which may serve as guidelines but do not present bright lines) there is, historically, a total lack of

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220 *Cooper v Boyes* 1994 (4) SA 521 (C) 535, supported by academic contributions such as Cassim *Company Law* 213-215 (and the authorities cited therein), A Milne et al *Henochsberg 1973* 175-178, Blackman et al *Commentary* 5-166 – 5-168, or F Oditah "Takeovers, share exchanges, and the meaning of loss" (1996) 112 *Law Quarterly Journal* 424 426.

supplementary jurisprudence, in terms of both rulings and academic attention, on the securities concept in South African law. This is not to say that, once all aspects of the domestic law that deal with securities are coherently viewed together, such a jurisprudence cannot be found – merely that where it is currently implicit, it must be abstracted and made explicit.[221]

The answers to the first and second questions posed above yield two important observations. First, it becomes evident that the securities concept can be further differentiated into: (1) a broad, free-standing securities concept, with little critical legal thinking behind it; and (2) a narrow, legislated securities concept, reoccurring in a slightly different form in each act which uses it. By way of example, the 1973 Companies Act utilised the broad securities concept in its definition of debenture in s 1, but used the Stock Exchanges Control Act's iteration (or version) of the narrow securities concept in s 134, and later in s 91A and 440A. Second, it can be argued that different risks arise in the different uses of the concept. When the legislature (which already historically evidences a pronounced share-centricity in its approach) uses the broad securities concept, it incurs uncertainty-driven application risk; when it borrows a narrow securities concept from another Act, it risks purposive incongruity.[222]

This provides an implicit answer to the third question. By substituting, in function although not form, the old debenture concept with the (debt) securities concept as the central construct in the Companies Act, the law's terminology began to mirror more closely that of the commercial reality.[223] This was a desirable policy shift, and in principle it could have been both effective and appropriate to phase in the securities concept.

However, in not providing its own substantive contribution to the concept in s 1 (relying rather on the broad securities concept), the legislature incurred a marked degree of application risk as outlined above.[224] Further, in relying on a narrow securities concept from another piece of legislation in s 134 and later s 91A and s 440A, it risked purposive incongruity. Additionally, share-centricity in the use of the term securities within the overall scheme of the Act (to deal with shares and debentures equally for a number of different purposes) risked neglecting some important differences between debt and equity securities. Yet, to the credit of the legal and commercial minds of the era, the Act presented no material problems in practice.

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221 Which, as stated in Chapter 1, is one of the principle aims of this dissertation.

222 See above at § 3 1 3 1.

223 The strength of this approach, however, lies (1) in a robust and accurate legal understanding of the securities concept, and (2) adequate differentiation of debt, equity and other securities in certain of the current Companies Act's provisions. While the second point (amendment of the Companies Act of 2008) is beyond the scope of this work, Chapter 6 (developing such a securities concept) is devoted to illustrating the first point.

224 See § 3 1 3 2.

In this light, despite these risks, was the approach of the 1973 Act to the securities concept nevertheless "*effective* and *appropriate*"? From the obvious lack of legal critique or contention it seems the approach was *effective*. However, from the above, three reasons emerge showing it may not have been entirely *appropriate*.

The first is policy-oriented. It could not have been the intention of the legislature that the name by which a financial instrument is referred to should determine whether a particular set of legal principles apply or not. This would have allowed unscrupulous companies to circumvent regulation in terms of the Act by, for instance, issuing a high-volume of smaller documentary loans (secured or unsecured) in series and simply naming them something else. Conversely, companies could create a contract or instrument which is not inherently a security from a substantive perspective, and give it the status and legitimacy (and therefore allure) of a security simply by naming it one,[225] though this would of course come with a number of costs due to the application of regulation to it *as a security*. The first problem – issuance of an instrument that is substantively a security but may not be regulated as such because it is not called a security – seems the more potentially pernicious.

Further, it would imply an unacceptable level of legal uncertainty to both lenders and corporate borrowers, the principal negative outcome of which would be a chilling effect on financial innovation as a result of increased compliance costs and risks. Moreover, regulators could find themselves unable to implement appropriate regulatory measures for *new* financial instruments that may have some but not all of the qualities of debentures or other known debt securities. A good hypothetical example is a swap of which holdership of both the fixed and variable legs are contingent on register entry, limiting enforcement of both contractual positions to the registered holder despite any cessions of the underlying beneficial interest. Lastly, the law would potentially be unable to offer comprehensive protection to investors outside of the formal exchange marketplace, where debt securities are quite prevalent.

The second reason is the potentially detrimental influence on subsequent legislation. After the establishment of the post-1973 regime, laws such as the Securities Services Act or the Insider Trading Act[226] had to be drafted so as to be in harmony with this dispensation. This is so with all interrelated legislation. Case law from 1973 onwards also began to develop a sophisticated understanding and interpretation of the Act. The same applies to academic commentary. Such laws,

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225 The instinctive rebuttal to this contention, of course, is *plus valet quod agitur quam quod simulate concipitur* (of which *non quod dictum est sed quod factum est inspicitur* is another variation) – the law gives effect not to what is said to have been to be done, but what has manifestly been done. However, how is the law to determine what "manifestly has been done" where there are no substantive guidelines, a set of first principles or bright lines for it to resort to? This is also linked to the observations on uncertainties surrounding the meaning of debenture as a legal signifier, made above in § 3 1 3 2.

226 36 of 2004, and 135 of 1998, respectively.

case law, commentary and associated emergent legal principles have in many instances outlived the 1973 regime, remaining relevant and exerting much influence on the Companies Act of 2008.

Thus it can be said that the 1973 approach continues to influence the current companies regime. Most importantly, it certainly had an influence on its inception and drafting. The most salient example of this is the current Act's wording in s 43(1)(a)(i) ("debt instrument…includes any securities other than…shares"). It can be subject to much of the same criticism levelled at the 1973 Act here. It makes far more sense to refer rather to "debt securities", because *securities* remains the pivotal classificatory and identificatory concept.[227] Yet without a substantive definition, the same problems persist. Also, an undifferentiated approach to debt and equity instruments is evidenced by some of the provisions.[228]

Third, the financial environment has changed. The recent and rapid developments in the financial marketplace highlight that an absence of problems in the past does not imply a lack of latent issues in principle. Debt securities now occupy a far more prominent position in the overall securities industry, and are crucial, for instance, to securitisation techniques, and are still (despite, or perhaps because of, the lessons learnt during the 2008 financial crisis and subsequent Great Recession) used by a large number of institutions essential to the financial system. Financial innovation and new emergent types of financial instruments are also more prevalent, as is market volatility. Thus strong, adaptable and robust legal regulation has become far more necessary than before; conversely, classificatory uncertainty holds more risks for the accurate and appropriate application of the law than in the past. The current developments in terms of the South African sovereign (and consequently other macro-prudentially important domestic financial institutions') credit ratings also means their importance is likely to increase, as they similarly did during the 1980s.

In conclusion, a lack of historical legal development regarding the securities concept (despite its central importance) is readily apparent from the above analysis. Presumably, the securities concept is in fact objectively ascertainable. Simply, it appears to refer to a general class of incorporeal[229] financial "instruments",[230] each usually comprised of a bundle of personal rights, the totality of which constitutes movable property and is regarded as a patrimonial *asset*, and which mostly involves a register which determines the manner in which rights and duties are administered and exercised.

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227 See Chapter 6.

228 Of which the use of the term security in s 44 & 45 (financial assistance), despite the sections having little to no practical bearing on debt securities, is a good example.

229 With the notable exception of non-dematerialised bearer securities.

230 An "instrument" has best been described as "a document of title to money…a documentary intangible" – R Goode *Commercial Law* 3 ed (2004) 476. See also Cowen & Gering *Negotiable Instruments* 23-28 as well as 31 (for commentary on Goode's description). This description is, obviously, too narrow to be of use in the present context.

Yet there is no jurisprudence with which, practically, to make an informed classificatory decision when confronted with an ambiguous factual matrix.

This is the key unintended consequence of the conceptual shift argued to have materialised post-1973. Although use of the securities concept is the correct approach, by virtue of history it creates far more legal issues than was (and perhaps still is) realised. The *broad* securities concept was – in principle rather than practice – too uncertain to function in the intended manner. Also, many of the differences between debt and equity were elided by the 1973 Act's share-centric provisions and, as will be shown in Part 2 of this work, the current companies regime's use of the securities concept has only exacerbated this problem.

Further, use of a *narrow* securities concept (the Stock Exchanges Control Act and its successors' iterations) in company law held the potential, due to purposive incongruity,[231] for inappropriate legislative outcomes. For instance, in the following section it will be shown that one of the most tangible (and illustrative) outcomes of this phenomenon was an unnecessary delay in the dematerialisation of debt securities of almost ten years relative to the dematerialisation of equities, and almost fifteen years in the case of money market securities.[232]

However, most fundamental is the problem of classification and identification, and the contingent ability to apply the appropriate legal rules to the appropriate financial instruments. This problem of application risk has been inherited by the current companies regime and must be clarified: the uncertainty regarding the content of the broader securities concept, despite its prevalence in the 2008 Act, is at the core of this problem. This is dealt with in detail in Chapter 6.

3 2 Relevant legal developments in the securities-market environment

At the start of this Chapter, it was stated that:

> "the current state of the law regarding securities has largely converged on what has emerged from the law on company securities…"

Nonetheless, there is a little more to it than that. A material portion of the law of securities lies beyond company law. Much of this, in turn, is centred around securities market-mechanisms and financial institutions (Strate Ltd and the JSE are good examples of both). It is the legal aspects of this latter

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231 See also above at § 3 1 3 1 and Chapter 1, § 1 1.

232 See § 3 2 2 1 below.

category (market mechanisms and institutions) that have thus far been referred to as stock exchange law, but is better referred to as securities exchange law.

Within this area of law and practice there are two historical features which contribute significantly to a better current understanding of the legal nature and operation of debt securities in South Africa. First are the structural features of the secondary market *before* the advent of uncertificated securities, and particularly the emergence of collective deposit. Second is the origin and implementation of uncertificated (registered) securities, as de-certification affects the general operation of the law surrounding debt securities.

As seen in the last Chapter, during the late 1980s and throughout the 1990s, the South African financial marketplace underwent a significant process of legal and institutional rationalisation. This was partly a function of international trends, but also largely due to a high inflationary domestic environment,[233] calling for systemic financial adaptation. Specifically, the role of merchant banks and investment firms as an institutional intermediary between the market and the public at large became more important, filling the gap left by other deposit-taking institutions (such as building societies) rendered defunct by the regulatory shake-ups. In fact, the role of the banking industry in the domestic financial sector has defied international trends and "the large banks…actually increased their share of financial intermediation"[234] and have increasingly expanded their offerings far beyond traditional banking products to move towards a more integrated financial services offering model.

This process of macroeconomic and institutional change brought with it significant legal change that affected, and continues to affect, the nature of debt securities. A second major, and international, trend during this period is the exponential growth in securities trading volumes. This necessitated significant structural changes to the way in which securities were transferred. These developments begin with the emergence of collective custody of security certificates and – at least as far as registered securities are concerned – end with the dematerialisation of securities.

Lastly, it is important to note that what follows is intended to reflect the views of then-contemporary authorities on the law as it stood and as it changed. Thus, unless the context explicitly indicates otherwise, it does not reflect the law of today, as this is neither necessary nor contributory to the exposition in this chapter.

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233 See also the Financial Services Board *Report of the Committee of Investigation into The Promotion of Equal Competition for Funds in Financial Markets in South Africa* (1992) 1-2 (hereafter the "Jacobs Report").

234 P Skerrit "The Financial Landscape" in C van Zyl, Z Botha, P Skerrit & I Goodspeed (eds) *Understanding South African Financial Markets* 3 ed (2009) 19.

3 2 1 *The international emergence of physical deposit of securities*

Collective securities depositories have been an international phenomenon since the early 19th century. They are fundamental to easing the administrative burden of "clearing and settling" (i.e. effecting) the purchase and sale of securities in an environment of increasingly high transactional volume and velocity, as well as complex intermediation. Collective deposits rose to prominence during the second half of the 20th century, as the volume of securities began to strain the existing trading infrastructure. This was made especially acute by the integral role of paper ("scrip") in each transaction. This has been referred to as the "paper crunch" or "paper avalanche" which started to gain attention in the 1960s,[235] and by 1990 led to the JSE's pursuit of a "scrip bank" and the subsequent immobilisation-dematerialisation process.[236]

It was observed in Chapter 1 that although securities can be grouped using a variety of metrics, the most analytically useful distinction is between registered and bearer securities. Different jurisdictions have a different mix of these securities, but typically one form exerts primacy over the other. This had a profound impact on the solutions to the problems of paper-based trading. The seeming convergence on dematerialised securities trading via electronic ledger entries began in jurisdictions where bearer securities dominated the trading market. As a result of these securities' corporeal properties they could be deposited with intermediary – or rather depository – institutions, who would evidence depositors' holdings via book entry (signifying the economic equivalent of the deposited bearer securities). This "pooling" of physically certificated securities at a central transactional intermediary is better known as the *immobilisation* of securities. Using immobilisation, trading, and specifically its clearing and settlement operations, could be done faster and more efficiently.

The problem in registered securities-dominated trading markets was that securities, being incorporeal, could not be so deposited in the strict sense. Nonetheless, these securities' architecture allows registered and beneficial holdership to be split, so that a holder of the former may become the nominee of the holder of the latter. Using this property, these registered securities-oriented jurisdictions were able to simulate the effects of true collective deposit. The main thrust of legal development and change occurred during the 1980s and early 1990s, and is the focus of the current section.

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235 Malan *Collective Securities Depositories* 1; see also Benjamin *Interests in Securities* (2000) 20-21, and MJ Aronstein "The decline and fall of the stock certificate in America" (1978) 1 *Journal of Comparative Corporate Law and Securities Regulation* 273.

236 FR Malan "Depositories, nominees and the uncertificated security" (1987) 9 *Modern Business Law* § 2, specifically 73; and M Vermaas "Die wet op die veilige bewaring van effekte" (1996) 8 *South African Mercantile Law Journal* 190 194; all quoting the JSE's 1971 Annual Report. See also P Skerrit "The Financial Landscape" in *Understanding South African Financial Markets* 3 ed 13.

3 2 1 1 Bearer Securities – Germany and the USA

In jurisdictions where traded securities are primarily "to bearer", and thus as a point of departure negotiable, the right "follows" the paper. Therefore, they were treated as corporeal movables. This did not allow, doctrinally speaking, for the elimination or substitution of paper in the transactional process, as transfer of ownership would be contingent, at least, on physical delivery (*traditio*) of the document.

The solution was to pool securities collectively in the safe custody of transactional intermediaries, where accounts held at these intermediaries (or accounts held between different intermediaries – often by intermediaries of intermediaries) could be debited and credited to represent changes in ownership. In this manner, delivery became notional, and the securities remained in one place whilst an entitlement to their patrimonial value was reflected by book-entry.

In collective deposit, securities of the same issue were treated as fungibles within each depository (serial numbering, if present, notwithstanding), and the individual owners obtained a right equivalent to, or actual, co-ownership in that class of securities in the overall collective depository. Such depositories may be referred to as "true" collective securities depositories, as the corporeal thing was physically and legally deposited. Jurisdictions with this system included Germany, the Netherlands, and the USA. The first and last mentioned will be dealt with in some additional detail to illustrate the nature of such a system.

In Germany, securities were typically *Wertpapier* and thus inherently negotiable.[237] Most securities were held in bearer form – *Inhaberwertpapier*.[238] Governed by the provisions of the *Depotgestez* ("*DepoG*")[239] in conjunction with banking and general securities law,[240] deposit rested on a number of specific intermediary relationships. Physical securities were deposited by the owner, or by a broker on the owner's behalf, with a bank ("depotbank" or depository bank). This deposit was evidenced by book-entry, and the securities were placed in the bank's collective depositories. Occasionally, the process would end here (this type of deposit was referred to as "*Haussammelverwahrung*"), but most often it did not.

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237 See, importantly, Chapter 2, § 2 2 1; as well as Malan *Collective Securities Depositories* 7, 8, 9 & 10-11.

238 By 1982, 80% of German securities were to bearer – Malan (1987) *MB* 74-75. See also Malan *Collective Securities Depositories* 9, 10 & n 34;

239 The *Gesetz über die Verwahrung und Anschaffung von Wertpapieren* 1937, enacted on the impetus of the work of Georg Opitz and Hans Schultz on constructive possession in the form of book entry when securities were so deposited – E Micheler "English and German securities law: a thesis in doctrinal path dependence" (2007) 123 *Law Quarterly Review* 251.

240 See for example s 16 of the *Wechselgesetz* for protection of *bona fide* purchasers of bearer instruments, or s 1(1) and (2) of the *Kreditwasengesetz* for the classification of, for example, the administration of securities as "banking transactions" – as in Malan *Collective Securities Depositories* 11 as well as M Vermaas *Aspekte van die Dematerialisasie van Genoteerde Aandele in die Suid-Afrikaanse Reg* LLD thesis UNISA (1995) 356.

Thereafter, a bank usually deposited the securities with *its* depository – a *Wertpapiersammelbank*, of which there were seven by the mid-1980s.[241]These *Wertpapiersammelbanke* (or *Kassenvereine*) were specialist central securities depositories with whom only other banks were allowed to hold accounts (rather than brokers or members of the public). Here securities would be re-deposited by the depository banks (this type of deposit was referred to as "*Drittsammelverwahrung*"). At the *Wertpapiersammelbank* the depotbank's deposits were similarly evidenced by book-entry,[242] and the legal relationship existing between the two types of banks was one of mandatory trust, or *Ermächtigungstreuhand*.[243] A depotbank's relationship with the true owners was also seen as that of mandatary.[244]

The German system was premised on depositors' proportional entitlement in the collective body of that type of security[245] held by the *Wertpapiersammelbank*,[246] and evidenced by book entries maintained between banks. To address criticism that the system had to some degree transformed the *Wertpapier* into a *Wertrecht*, the *DepotG* facilitated the replacement of the individual certificates at the *Wertpapiersammelbank* with deposit of a "global certificate" ("*Sammelurkunde*").[247] This certificate consolidated all the similar securities (i.e. those considered fungible *inter se*) into a single certificate. Nonetheless the individual securities holders were, in certain circumstances, allowed to demand an individuated certificate, necessitating the issue of a new, amended global certificate.[248]

In this regard E Micheler also provides some useful background:[249]

> "In the context of German and Austrian legal doctrine, securities certificates perform two important functions. The first is that upon acquisition of possession to the securities certificate the buyer becomes the

241 Malan *Collective Securities Depositories* 12 & n 46; Malan (1987) *MB* 74 & Vermaas *Dematerialisasie* 356-357.

242 Malan *Collective Securities Depositories* 11-13; Malan (1987) *MB* 74; Vermaas *Dematerialisasie* 359.

243 Malan *Collective Securities Depositories* 19.

244 Malan (1987) *MB* 74.

245 I.e. of the same issue, being (quasi-)fungible despite individual numbering.

246 Malan (1987) *MB* 74 & Malan *Collective Securities Depositories* 13-14 & Vermaas *Dematerialisasie* 356-357 & 359. The vesting of co-ownership ostensibly took place by operation of law upon deposit.

247 Section 9a, operative since 1972.

248 Malan (1987) *MB* 74 & Malan *Collective Securities Depositories* 34-38.

249 E Micheler *Property in Securities: A Comparative Study* (2007) para 11 [taken from Yeats et al *Commentary 2008* "Introduction to and overview of Part E of Chapter 2" (2-506 *et seq*) n 519, which also provides some comparative insight into the French system, quoting from MD Diathesopoulos "Interests in securities under a comparative law approach" 2010 *PFESR Annual Review* 9:

> "With a series of laws, the (initially mandatory) deposit of (initially anonymous) shares was imposed since 1941 at Caisse Centrale de Depots et Virements de Titres (CCDVT) that was formed as a type of société anonyme company by the law of 18. 6. 1941 (and the decision of 15.9.1941). The CCDVT was the precursor of the Société Interprofessionnelle pour la Compensation des Valeurs Mobilières (SICOVAM), founded in 1950, also as a société anonyme type of company. The organization for the optional deposit of shares to SICOVAM consisted of a first and a second stage deposit: the deposit of securities to an institution participating in the system came first (to an établissement affilié that is, therefore a bank, stockbroker) which then deposited them into an account that SICOVAM maintained under his name."

> owner of bearer securities. The second is to provide for a legal explanation of the rules protecting the buyer against adverse claims arising out of unauthorised transfers.
>
> …
>
> [For that reason]…German and Austrian service providers adopted a solution that maintained securities certificates because securities were deposited with central depositories. Many years earlier, in 1850, the banks in Berlin had established a financial intermediary called the '*Kassenverein'* which facilitated money transfers between its members. Over time, the *Kassenverein* was also employed by banks to deposit securities they held in their own name. During the post-war crisis, the banks decided also to deposit client securities centrally with the *Kassenverein* and in order to save cost, the securities were to be kept on an unallocated basis. The *Kassenverein* was to keep records of the entitlements attributed to each of the banks, who in turn kept records of client entitlements. The securities were to be held by the *Kassenverein* as a bailee albeit with the name of the client owner being undisclosed to them. The identity of the client was, however, ascertainable through the depositing bank.
>
> In 1925, the banks in Berlin approached their clients, asking them to approve of the new arrangement allowing banks to transfer client securities to the *Kassenverein* and agreeing for the securities to be kept there on an unallocated basis…
>
> Banks in Frankfurt am Main, Dresden, Essen and Stuttgart followed the example of the banks in Berlin and created their own central depositories…The result was that a handful of regional depositories held a significant proportion of securities in Germany, linked with each other through accounts. Each depository serviced the banks and clients linked to it by acting as a central depository for securities physically located with it but also by acting as an intermediary for securities kept with any of the other depositories. When securities were transferred, they no longer had to be physically moved; rather, they were transferred through book entry."

Transfer of securities was facilitated by two sets of contractual relationships. The first was between the depositors (i.e. sellers and buyers, or in more limited instances brokers not operating within the banks) and their depository banks (as mandatories), and the second between the depotbanks and the Wertpapiersammelbank (also as mandatories). On instruction, the seller's bank would (1) debit the seller's account, and (2) sell the securities to the buyer's bank. This intermediary sale would be effected by a debiting and crediting of the selling and buying banks' accounts at the *Wertpapiersammelbank*. The buyer's bank would gain a fleeting co-entitlement until it credited the account of the buyer, after which the buyer would be in a position of co-entitlement identical to that of the seller before the transaction.[250] The *inter partes* relationships between the owners and further intermediaries, such as extra-bank brokers, have no bearing on the transactional mechanics of the

250 Malan (1987) *MB* 74 & Malan *Collective Securities Depositories* 22-25. See also Vermaas *Dematerialisasie* 356-362 generally for the operation of the German system.

collective depository or depositories in question. The Dutch, Austrian, Swiss and Japanese systems followed this type of model,[251] and in Germany today most non-equity securities remain, at least by way of legal fiction, *to bearer* despite having been dematerialised.[252]

In the USA a similar system prevailed. This is despite the fact that its securities law emerged (much like South Africa) from an English law paradigm, with a corresponding prevalence of registered securities. Why? Briefly, after passing of the Uniform Stock Transfer Act of 1909, trading market securities were seemingly regarded as negotiable instruments, and were in certain circumstances treated as such by the courts even earlier.[253] The crisis of increasing volumes of paper was particularly acute in the United States.

By 1977 section 8-102(1) of the Uniform Civil Code was amended to provide for uncertificated (capital market) securities, despite the doctrinal contradiction of a paperless negotiable instrument – much like the case of German government securities as above. The amendment placed the responsibility of maintaining the records of uncertificated "ownership", or rather entitlement, with the issuers of such securities.[254] In this way American collective securities depositories also immobilised securities in collective custody. There emerged four major collective securities depositories – the Deposit Trust Company, the Pacific Securities Depository Trust Company, and the Midwest Securities Trust Company,[255] and later the Federal Reserve Board.[256]

Immobilised but *certificated* securities were held in the name of the nominees – a nominee typically being either a subsidiary of the depository, the owner's broker, or a broker's nominee. The beneficial owner of the securities remained co-beneficial interest holder in the fungible bulk of that class of securities in physical deposit. The owner would entrust the securities to a broker or a bank for safe custody. The bank or broker would have an account with a collective securities depository and deposit the securities with the latter, which would credit the depositor's account.[257]

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251 Malan (1987) *MB* 74 & Malan *Collective Securities Depositories* 2-3.

252 See Chapter 2, § 2 2 1; and Micheler (2007) *LQR* 279-280.

Interestingly, whilst German government securities administered by the central depository had *no physical certificates*, they remained subject to the same fictional possessory regime.

253 Malan *Collective Securities Depositories* 84 & generally § 4.5, 84-88; see also Vermaas *Dematerialisasie* 205-207, including the instances where the full spectrum of characteristics of negotiability were limited by the Uniform Civil Code.

254 Malan *Collective Securities Depositories* 75, 84-88 & 88-91; Malan (1987) *MB* 75-76 & Vermaas *Dematerialisasie* 207-210.

255 Malan *Collective Securities Depositories* 77 & Malan (1987) *MB* 75.

256 Vermaas *Dematerialisasie* 346.

257 Malan *Collective Securities Depositories* 77-80 & Malan (1987) *MB* 75.

With the advent of uncertificated securities, it became slightly more complex. Here the issuing company remained responsible for keeping a record of ownership and transfer *by registration* (replacing the certificated security with the issuer's register entry), and the company had to allow the registered owner to exercise all rights conferred by the security. The holding of these securities was effected through the issuer registering a "clearing corporation" or "custodian bank" in its securities register, while the true owner of the security held an account with the latter (acting as that owner's nominee). When held through the existing system of collective deposit, the collective securities depositories fulfilled this role.[258] If held in this way, the true negotiability of the (intangible) register entry is doubtful, as each individual's interest appears not to meet all of the criteria of negotiability. It would seem that "negotiability" in this context was more simulated than real – a fiction functioning to overcome certain doctrinal inconsistencies in order, for example, to protect *bona fide* acquirers or to allow simple real security arrangements.[259]

In order to transfer securities between participants of collective securities depositories, section 8-320 of the UCC stipulated that transfer of ownership could occur by debiting and crediting of buyers' and sellers' accounts on instruction. This dispensed with the need for delivery of a certificate or change in the register of the issuer – the collective securities depository itself held the certificate or was registered as nominee owner, and reflected the true state of affairs by book-entry alone.[260] However, the federal-level UCC has never been the default or generally applicable law – thus individual states could chose to adopt these provisions of the UCC. The more important point here is that these amendments made immobilisation and dematerialisation legally *possible*, and this seems to embody what was considered best practice in the US.

The importance of these developments in bearer-oriented jurisdictions is not to be underestimated. Owing to the fact that such securities had a (at least putative) corporeal character, the physical deposit of these securities, in order to facilitate transfer by book entry, was a readily available and very effective solution. Having successfully adopted this solution to the problem of paper, it would appear that these jurisdictions' advancements began to exert influence on registered securities-oriented jurisdictions facing similar challenges. However, without corporeality, "true" deposit was not possible, and creative solutions were required to simulate the advantages of deposit. Herein lies the foundational aspects of much of South Africa's current securities depository dispensation, and the

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258 Malan *Collective Securities Depositories* 80-81 & 88-91; see also for transfer arrangements Malan (1987) *MB* 75 & 77. See also generally for the above Vermaas *Dematerialisasie* 211-213 & 215.

259 Malan *Collective Securities Depositories* 103-104 & Malan (1987) *MB* 77. There are parallels here to the function of the global certificate in the German system and follows largely the narrative of doctrinal rigidity in institutional and legal development, which is the centrepiece of Micheler (2007) *LQR* 251.

260 Malan *Collective Securities Depositories* 80-81 & 96-100; Vermaas *Dematerialisasie* 213 & 226-227.

legal adaptations necessary to implement this solution is the focus of what follows, and largely supports the more theoretical outcomes in the context of uncertificated securities of Chapter 5.

3 2 1 2 Evidentiary certification – England & South Africa

In stark contrast to jurisdictions where the securities certificate embodies its rights, is the system of England, as superficially received in South African law.[261] These jurisdictions' markets, in their modern form, are dominated by *registered* securities. Certificates serve a merely evidentiary purpose and there is no "indefensible nexus" between a physical paper certificate as record of holdership on the one hand and (actual holdership of) the rights underlying these securities on the other. This is the essence of the registered security, for which:[262]

> "certificates merely *represent* the registered securities. Certificates do not *constitute* the securities, and a person does not automatically acquire legal ownership of the security by having possession of the certificate."

For this reason they are treated as movable, *incorporeal* property, or in the parlance of English law, choses in action.[263]

The "instrumentality" (i.e. the physical manifestation of) of registered securities is vastly different to that of the bearer securities discussed above. Two points are of importance in this regard. First, certificated registered securities have a *dual* instrumentality: physical certification serving as prima facie evidence of registered holdership of the security, and physical entry on the securities register facilitating the exercise of the rights of such a registered holder (together conferring "legal title"). Second, registered holdership itself is not necessarily determinative of holdership of the *patrimony* associated with a particular security, as a handing over of this (dual) instrument from one person to another does not automatically cause a transfer of the beneficial interest underlying the security. In direct contrast to bearer securities, one can say that the paper follows the right.

Where a security is the sum of a collection of personal rights without a corporeal dimension in the legal sense, there can be no true deposit, and therefore no true collective securities depositories.

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261 See also Chapter 2, § 2 3; and § 3 1. For a reconciliation between this received system of English constructs and the underlying South African private law system, which is Civilian, see Chapter 4 generally.

262 Benjamin *Interests in Securities* (2000) 32-33. See also Chapter 1, § 1 1.

263 Benjamin *Interests in Securities* (2000) 34, and Gower *Modern Company Law* 358, although Gower does state that:

> "This, however, is not helpful, for "chose in action" is a notoriously vague term used to describe a mass of interests which have little or nothing in common except that they confer no right to possession of a physical thing, and which range from purely personal rights under a contract to patents, copyrights and trademarks."

Thus, subject to very few exceptions, England and South Africa implemented collective "deposit" in name only.[264]

England will be discussed first. The above doctrinal state of affairs fed into the traditional process of the transfer of securities on the London Stock Exchange ("LSE").[265] Under the English system (described as it was viewed during the emergence of collective deposit), brokers would deal directly with clients. Brokers, in turn, transacted with jobbers to complete a transfer.[266] Both functionaries acted in different capacities, but were all members of the Exchange. On instruction, a broker concluded a sale with a jobber – who would pay for and take up the shares by registered transfer and transact with another jobber, or directly with another broker to sell the shares to the eventual buyer.[267] This, of course, required a number of registered transfers along with large amounts of paper work. The transfer of equitable (i.e. beneficial) ownership interests would then, typically, follow a similar route.

The LSE experienced great increases in trading volumes already in the 1960s, escalating rapidly during the late 1980s, and culminating in widespread administrative problems in the aftermath of the 1987 crash.[268] The first radical policy-shift occurred in 1979 when the Exchange introduced Talisman, a computerised clearing and settlement platform.[269] Talisman made use of SEPON, a nominee company of the LSE. Companies, through the operation of an amendment to s 80(1) of the Companies Act 1948 in conjunction with s 1 of the Stock Exchange (Completion of Bargains) Act 1976 were exempted from issuing certificates to a "stock exchange nominee company" such as SEPON. SEPON held an account for every company listed on the LSE and had only to issue new certificates to the eventual (registered) transferee.[270]

Thus transfers of securities could be effected through a transfer by the seller to SEPON, and a transfer by SEPON to the purchaser, without the company having to issue certificates to SEPON as intermediary.[271] The necessary intermediate transfers – from seller's broker to jobber, perhaps to

264 See below § 3 2 2 and § 3 2 3.

265 Malan *Collective Securities Depositories* 122-123 & n 85.

266 Until the reforms of the "Big Bang "or "Paper Crunch", where these roles were merged.

267 Malan *Collective Securities Depositories* 123-124.

268 Micheler (2007) *LQR* 265.

269 Malan *Collective Securities Depositories* 115; Malan (1987) *MB* 78; Vermaas *Dematerialisasie* 172.

270 Malan *Collective Securities Depositories* 118-120; Malan (1987) *MB* 78; Vermaas *Dematerialisasie* 174-175.

271 Malan *Collective Securities Depositories* 122 & Malan (1987) *MB* 78; Vermaas *Dematerialisasie* 174, n 60 & n 61.

another jobber, and then to the buyer's broker – were all contractual, and effected by electronic book entry via SEPON.[272]

SEPON, as a "bare trustee", would gain a very brief legal title (i.e. registered ownership) of the shares without the issue of a certificate, and the true owners of the securities (in a simple transaction: seller, selling broker, jobber, buying broker, buyer) held a proportional co-ownership in the overall pool of that particular class of securities at SEPON. The distinction between jobbers and brokers was phased out in the mid-1980s, and the roles merged.[273] Securities of the same kind, once deposited at the Settlement Centre with SEPON as nominee, are treated as fungibles or quasi-fungibles, facilitating co-ownership.[274] Through this system, the LSE utilised certain elements of the collective securities depository system to implement an electronic clearing and settlement platform; however, it did (and could) not effect collective deposit in the true sense, which was in any event not necessary under the English regime.

Talisman, as clearing and settlement system, facilitated the transfer of securities without the interceding transfer, registration, and destruction and re-issue of certificates for the various intermediaries, replacing the evidentiary function of the certificate with an entry in a central registry of issuers (SEPON under Talisman). This registry evidences holdings of securities by each issuer (replacing the issuers' registers in this limited capacity) and uses book-entry to reflect changes in ownership of shares. Whilst it was not a *true* collective securities depository, it gave brokers the advantages of a depository via book entry and dispensed with certification during the clearing and settlement stages of trading.[275]

At the same time, this did not amount to total dematerialisation either – it merely de-certificated the evidencing of legal title when held by exchange intermediaries.

The Central Gilts Office came into operation in October 1986, and fulfilled the same function as SEPON for government debt securities.[276] Later, the failed project Taurus and its successor Crest would make provision for the ownership and transfer of fully uncertificated listed securities, and remove paper from the equation entirely.[277] Crest fulfilled the clearing and settlement function of the old system electronically, as well as becoming, for legal purposes, the maintainer of the securities

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272 Malan *Collective Securities Depositories* 124 & Malan (1987) *MB* 78; see also generally Vermaas *Dematerialisasie* 173-176.

273 During the so-called "Big Bang" – see for instance Vermaas *Dematerialisasie* 167; and Malan (1987) *MB* 78.

274 Malan *Collective Securities Depositories* 126-127.

275 Vermaas *Dematerialisasie* 176-177.

276 Malan (1987) *MB* 78, and also Malan *Collective Securities Depositories* 117 & n 61.

277 Micheler (2007) *LQR* 265-271 & Vermaas *Dematerialisasie* 165, 179-188 & 188-198 – the *Taurus* project collapsed in 1993, and along with Talisman it was replaced by *Crest*, a fully-fledged uncertificated trading platform – see also § 3 2 1 3 below.

register of the issuers of listed securities, much like STRATE Limited, and eventually Strate Ltd,[278] as described below.

This leads to a slightly more detailed discussion of the evolving position in South Africa. Here, implementation of collective deposit began in the same way. Initially security certificates were deposited into the custody of intermediary functionaries, who replaced the original holders on the securities register, acting as *collective* nominees for the true beneficial holders. Thereafter, legislation was promulgated to formalise and regulate this notional immobilisation (of listed securities only), reducing the administrative burden of paper-based trading at the JSE.[279] After listed shares and later debt securities were properly dematerialised, and exchange platforms were consolidated, Strate Ltd functioned for the most part as South Africa's sole central securities "depository".[280] A depositary in name only, it functions on the one hand as a clearing and settlement platform, and on the other as the keeper of a centralised ledger of holdings of dematerialised securities, with its participants maintaining sub-registers (reconciled daily with Strate's ledger).[281]

Before the remainder of this chapter can properly discuss the legislative process that led to the true dematerialisation of South African securities, a brief description of the South African paper-trading system and pre-statutory immobilisation is required. Such a discussion is also necessary for a proper account of certain facets of the current legal position, as well as certain theoretical conclusions – this is presented mainly in Chapters 4 and 5.

In South African law, a certificate similarly fulfils a mere evidentiary function, and securities are considered incorporeal movable property.[282] Like the English system (1) there can be no true collective deposit, because incorporeal things cannot be deposited, and (2) the evolution of a central securities depository in this context is a misnomer for the emergence of a system for the transfer and ownership of securities in uncertificated form, with a central securities "depository" to facilitate this. Thus, it becomes clear that statutory intervention was inevitable. Before this occurred, a less refined form of collective deposit emerged more organically, with banks and brokers as the central depositary intermediaries. However, first a brief discussion of the trading system that preceded this development is necessary.

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278 Share Transactions Totally Electronic.

279 The Safe Deposit of Securities Act 85 of 1998. *Talisman* fulfilled a similar function in terms of clearing and settlement, which was also first attempted by *Taurus*.

280 See Strate *Who and What is Strate?* <http://www.strate.co.za/> (accessed 25-06-2015).

281 Although s 43 of the Financial Markets Act creates a rebuttable presumption that the records of the Central Securities Depository are correct if inconsistent with those of a central securities depositary participant, the legally relevant register *in instances of dispute or inconsistency* remains the one maintained by the latter. This is, seemingly, also only applicable to company securities.

282 See also Chapter 2, § 2 2 1.

At the JSE, and generally in South Africa, there is no distinction between brokers and jobbers, and over time South African law has come to regard the nature of the legal relationship between client and broker as that of *mandatary*, rather than agent.[283] The client's instruction is to buy a *type* of security in a certain number, and in this context securities were "fungible by agreement".[284] Central to transactions was "good delivery",[285] which required the securities be delivered in "negotiable form" (i.e. with all the blank transfer and other documents necessary to effect a change in registered ownership). In most cases, the broker would fill out these forms to ensure the final purchaser is put in a position to become both beneficial and potentially registered owner.

However, as securities are bundles of personal rights, cession (a real agreement) had to occur to give effect to the transfer of the underlying bundle of rights – the beneficial interest.[286] In most cases, it was accepted that sellers provide their brokers with the necessary documentation with an *animus transferendi* "to whom it may concern".[287] As per the ordinary requirements for a valid cession, the object of the cession would have to be agreed upon, as well as be at least ascertainable if not certain.[288]

Thus, a transfer could only be valid (1) once the securities were identified, so that (2) the rights being ceded could be ascertained. At this time the *animus transferendi* would be correspondingly matched by an appropriately informed *animus accipiendi*, and the cession perfected.[289] This concept was taken up in the term "appropriated".[290] Here the certificates played a cardinal role, facilitating the ascertainment which perfected the cession. This also illustrates that certificates are not only evidence of ownership, but also evidence of the *content* (i.e. the beneficial interest) of the securities. This explains why delivery of the evidentiary securities certificate had to, in principle, accompany the delivery of the valid instrument of transfer.

Whilst this may seem to have been a questionable position (confusing the concept of ascertainability with ascertainment itself), it was not. First, the cession was "to whom it may concern" in an

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283 Initially, influenced by the English law position, a relationship of agency was inferred, as in *Koenigsberg's Trustee v Taylor* 1905 TH 227 284; but following a change in the JSE's Rules *circa* 1984 (§5.50.3 & 5.50.5) it was understood that the broker contracts in own name, on instruction from his client – see Malan *Collective Securities Depositories* 157-160 & n 93 for further relevant case law authorities.

284 Malan *Collective Securities Depositories* 161.

285 JSE Rules *circa* 1984 § 5.70.2.2 as cited in Malan *Collective Securities Depositories* 162-163.

286 As settled, and well elucidated, in *Botha v Fick* 1995 (2) SA 750 (A).

287 Malan *Collective Securities Depositories* 175.

288 See for instance Van der Merwe et al *Contract* 394-395, or S Scott *The Law of Cession* 2 ed (1991) 70.

289 GF Lubbe "Die oordrag van toekomstige regte" (1980) 43 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 117 132.

290 "[A] term of art", encapsulating (1) identification, and (2) ascertainment: *Estate Hunt v De Villiers* 1939 CPD 79 96; see also Malan *Collective Securities Depositories* 174 & 175.

environment where the *causa* for the cession (the mandate or sale agreement or both) was not always able to fulfil the function of informing the cessionary exactly what the beneficial interest (i.e. the object of the cession) is.

Second, this type of transaction was usually characterised by a fleeting interceding cession between the seller and the seller's broker. The broker often accepted the securities with *animus accipiendi,* and therefore herself acquired the beneficial interest, without registered ownership, prior to transfer to the buyer or buyer's broker. The seller's broker then had to effect a *second* cession, along with registered transfer, to complete the overall transfer.[291] The securities remained the property of the seller's broker, as the client's mandatary, until they were appropriated to the buying client or her broker. Registered ownership was usually, during these intermediary juristic acts, either in the name of the broker's nominee, or remained with the selling client until the transfer was complete and the issuer (upon receipt of the instrument of transfer) issued new certificates.[292]

During this period it is clear that beneficial interest and registered ownership did not necessarily travel along the same path in exchange transactions. Furthermore, the clearing house of the exchange functioned (via a constellation of clearing house agreements) as an *agent* for brokers, facilitating clearing and settlement of exchange transactions, and "…[regulating] the multilateral set-off of debts between participants…" – i.e. brokers and their nominees.[293] The principal legal role-players remained brokers, their nominees and clients.

In this light, the discussion turns to the earlier, more organic, emergence of collective deposit. Before the passing of the Custody and Administration of Securities Act,[294] s 2C(1) of the Stock Exchanges Control Act[295] allowed listed securities to be "deposited" with: stockbrokers (who in terms of the JSE Rules had to deposit them in a safe custody account at a bank); banks in terms of the Banks Act;[296] pursuant to unit trust schemes; and with attorneys, auditors, accountants or persons so designated by the Registrar of Financial Institutions, and later the Minister of Finance.[297]

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291 See Malan *Collective Securities Depositories* 170.

292 See Malan *Collective Securities Depositories* 162-165.

293 Malan *Collective Securities Depositories* 187.

294 85 of 1992, which was entitled the "Safe Deposit of Securities Act" until a 1998 amendment. This will be discussed in the following section.

295 The amended Act 47 of 1947 and then later s 4 of Act 1 of 1985 (of the same name).

296 23 of 1965.

297 Malan *Collective Securities Depositories* 218-219; Malan (1987) *MB* 79; FR Malan & MJ Oosthuizen "The safe deposit of securities" (1989) *Tydskrif vir die Suid-Afrikaanse Reg* 502 503 & Vermaas (1996) *SA Merc LJ* 190 & 191.

The focus here will be on the first two instances of deposit, as banks and brokers emerged as the primary depositories of securities.[298] Obviously it must be kept in mind that whilst the terms "deposit" and "safe custody" will be used, this is technically inappropriate – not only can incorporeal property not be deposited, but the deposit of a thing for return of a similar surrogate is also not true deposit.[299] The process was, in reality, two separate acts: the deposit of the physical securities certificates (mere paper without value) for safe-keeping, and the appointment of the broker or bank as mandatary, to administer and hold the securities in safe custody.[300] Further, the securities so deposited would ordinarily be held in the name of the depository's nominee.[301] The term "administer" included management of the investments (or the entire portfolio) so deposited,[302] implying the non-discretionary exercise of registered rights such as voting on behalf of, and on instruction from, the beneficial interest holder; or the discretionary management of the investors' interests.

Where given to a broker, the broker would issue a receipt and mark the certificates to facilitate identification of the beneficial interest holder, and re-deposit those certificates at a bank.[303] Where given to a bank directly for administration and custody, the securities would be held and administered in the owner's name, or bank nominee's name, or in trust, but in all cases constituting "trust property as defined in the Financial Institutions (Investment of Funds) Act 39 of 1984".[304] When in formal trust, beneficial ownership vested in the trust estate, but neither holding in trust nor holding pursuant to a unit trust scheme will be discussed further in this section. When in the nominee's name, the depositor remained the beneficial interest holder.[305]

Further complicating the matter was the use of global certificates, evidencing the holdings of multiple beneficial interest holders. Where there was additional evidentiary documentation (such as in the case of brokers, who were required to attach a slip to the certificate evidencing the holders' names), the position remained the same. However, where this was not the case, appropriation could not take

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298 Vermaas (1996) *SA Merc LJ* 192 & n 11; Vermaas *Dematerialisasie* 321.

299 There are exceptions to this rule, for example Krugerrands. The debate about whether this is an instance of true deposit, however, is neither still legally relevant nor central to this section – for more detail see Vermaas *Dematerialisasie* 315-318, and n 19-22 therein.

300 Malan *Collective Securities Depositories* 217 & 219; Malan & Oosthuizen (1989) *TSAR* 502-504; Vermaas (1996) *SA Merc LJ* 191-193; Vermaas *Dematerialisasie* 313, including n 3, & 320-321.

301 Vermaas (1996) *SA Merc LJ* 192.

302 Section 2C of the Exchanges Control Act of 1947 and s 4 of the 1985 Act - Malan *Collective Securities Depositories* 219 & 221. See also in the Act's definition of "portfolio manager", including both brokers and banks in this context.

303 Malan *Collective Securities Depositories* 219-221; Malan (1987) *MB* 79 & 80 & Malan & Oosthuizen (1989) *TSAR* 504 & 505; see also Vermaas *Dematerialisasie* § 3.3.1, 322-328 for a detailed account of the role of brokers.

304 Malan *Collective Securities Depositories* 221-222; Malan & Oosthuizen (1989) *TSAR* 505.
Many of these were not trusts in the formal, strict sense, but rather mere fiduciary arrangements.

305 Malan *Collective Securities Depositories* 224; Malan (1987) *MB* 79 & Malan & Oosthuizen (1989) *TSAR* 505; see Vermaas *Dematerialisasie* § 3.3.3, 336-340 for a detailed account of the role of banking institutions.

place because individual beneficial interest holders could not be identified.[306] This was especially true where transfers occur within a single block, or global, certificate.

This implies that beneficial interest holders were in all likelihood *co-holders* of the "fungible bulk" of beneficial interests so "deposited" (the global body of similar rights evidenced by the single certificate), or similar certificates collectively deposited.[307] This not only slightly altered the nature of the beneficial interest, it also affected the remedial position: there could be no individual declaratory orders or *quasi-rei vindicatio* available to individual investors.[308] Real security arrangements and pledge became equally complex. The main advantage (and goal) of this dispensation, however, was that banks and brokers with large volumes of securities on deposit were able to effect transfers with less administrative effort and paperwork, saving costs and providing investors with greater transactional safety.[309] However, to settle matters legally, legislative intervention was implemented.

3 2 2 Centralised, statutory immobilisation in South Africa

As is clear from authorities cited, the legal developments leading up to dematerialisation are well documented. What follows in this section and the next functions as a critical précis of that legal history, highlighting certain key aspects necessary for further theoretical analysis in the rest of this work, especially in Chapter 5 and its consequences for the some of the outcomes of Part 2.

In 1992 the legislature enacted the Safe Deposit of Securities Act, later known as the Custody and Administration of Securities Act.[310] This Act, from its definitional section, clearly only applied to listed securities,[311] and operated in conjunction with the Stock Exchanges Control Act. The Act functioned (1) to rationalise contentious aspects of the law of deposit where securities were concerned;[312] and (2) to facilitate the transfer of securities by book-entry via a central securities depository. It ushered

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306 Malan *Collective Securities Depositories* 221; Malan (1987) *MB* 79 & 80; Malan & Oosthuizen (1989) *TSAR* 505-506.

307 A view – correctly – submitted by Blackman et al *Commentary* 5-205 – 5-206; Malan in Malan *Collective Securities Depositories* § 6.11.5, 223; and Malan (1987) *MB* 79 & Malan & Oosthuizen (1989) *TSAR* 506; as well as Vermaas (1996) 196-197, and Vermaas *Dematerialisasie*

308 Malan *Collective Securities Depositories* 223-224; Malan (1987) *MB* 79; Malan & Oosthuizen (1989) *TSAR* 505-506.

309 Blackman et al *Commentary* 5-206.

310 85 of 1992.

311 The Act, in s 1, defined "securities" as:

> "any listed securities as defined in section 1 of the Stock Exchanges Control Act, 1985 (Act 1 of 1985), any listed financial instruments as defined in section 1 of the Financial Markets Control Act, 1989 (Act 55 of 1989), or any other securities approved by the Registrar by notice in the *Gazette* and all rights or other benefits existing in respect of or accruing to such securities or instruments, including any certificate issued in respect of such securities or instruments and of such rights or other benefits…"

312 Vermaas (1996) *SA Merc LJ* 191 – specifically authorities cited in n 8; Vermaas *Dematerialisasie* 374.

in a brief period of statutory immobilisation of securities (in the putative English-South African legal sense), ending with the dematerialisation of listed shares in 1998, and of debt securities and money market instruments from 2004 and 2009 respectively.[313]

Despite the organic development of a rudimentary system of collective deposit, structural features such as a lack of integration and co-ordination between the JSE's South African Settlement House ("SASH") and depository institutions, as well as amongst depository institutions themselves, was hampering the effectiveness of the market.[314] The Act introduced the concept of a *central* securities depository to South Africa (i.e. a "scrip bank") and co-ordinated the re-deposit of securities by various custodial depository institutions (still mainly brokers and banks) at such a central securities depository.[315] The Act achieved a truer form of immobilisation – the collective and *central* custody of securities and uniformly operationalised transfer, encumbrance and pledge by *book-entry* rather than the moving of paper and the issue of new or amended certificates. Nonetheless, it remained empowering legislation: a voluntary, structured alternative not only to non-statutory collective deposit,[316] but also to paper-based trading.

The Act allowed a depository intermediary (such as a bank or broker) to re-deposit the securities at a central securities depository, holding these securities collectively or separately. Securities of the same type and issue have the same value and rights-content, forming a fungible bulk of which the beneficial interest holder would then by operation of the statute obtain co-ownership (including any limitations on the rights existing pre-deposit) proportionate to what was deposited. This was reflected by book-entry at the depository institution, whose deposits at the central securities depository were reflected through further book-entry by the latter.

The co-ownership construction had a number of advantages. First, it allowed a beneficial interest holder to encumber and pledge her securities, whereas a mere personal right to delivery of similar securities would not. Second, the beneficial interest holder, as co-owner, was protected from the insolvency of the depository institutions or the central securities depository. Third, the risk of false or incorrectly delivered certificates was spread amongst depositors. The Act further created an indemnity in favour of the depository institutions and the central depository, protecting them from liability flowing from (1) the unlawful deposit of securities, and (2) scenarios where the stipulated beneficial interest holder-depositor was not, in reality, the holder of the rights associated with the

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313 See § 3 2 2 – it is argued that dematerialisation for all securities was in principle possible from 1998 onwards, although it seems this is in conflict with the prevailing opinion at that stage.

314 Vermaas (1996) *SA Merc LJ* 193 & Vermaas *Dematerialisasie* 341 & n 195-196.

315 Blackman et al *Commentary* 5-205; Vermaas (1996) *SA Merc LJ* 194-195; and Vermaas *Dematerialisasie* 340 & 384.

316 M Vermaas "Dematerialisasie van die genoteerde aaandeel in die Suid-Afrikaanse reg" (1997) 9 *SA Merc LJ* 42 [Part 1] & 171 [Part 2] 171; and Vermaas (1996) *SA Merc LJ* 210 & 211.

deposited securities.[317] However, the Act did not specifically address security of transfer, and made no material changes to the legal position of a bona fide acquirer.

In terms of the Act, only member-depository institutions were empowered to re-deposit and transact with the central securities depository (beneficial interest holders had no direct relationship with the central depository), and all securities so deposited had to be registered in the name of the central depository or its nominee (which was required to be a full subsidiary). The fungible bulk of each type of security could not be effectively immobilised and transferred by book-entry unless the central depository, or one of its nominees, was the registered holder of the securities.[318]

In order to protect investors, the depository institutions issued to each a supplementary certificate serving as *prima facie* evidence of such (beneficial) co-ownership.[319] The beneficial interest holder of any securities was entitled – particularly in light of the unavailability, by virtue of the co-ownership construct, of a *quasi-rei vindicatio* or declaratory order – to delivery of individual certificates equivalent to her deposits.[320]

Typically, the depository institution would hand over the securities in "negotiable form"[321] to the central securities depository, which would send it to the issuer for certification and registration in the name of the central depository or its nominee. The deposited securities were credited to the account of the depositor (either end-investor or her representative intermediary, such as a broker), and transfer was effected by book-entries at the central securities depository as nominee, reflected by corresponding book-entry at the depository institutions. The certificate and, more abstractly, register entry, remained immobilised.[322]

Transfer was primarily governed by s 5:

> "Transfer of securities or of an interest in securities held by a depositary institution shall be effected in terms of the rules of a central securities depository by entry in the securities accounts of the transferor and the transferee with the depositary institution or institutions concerned."

In this way transfer could finally be effected by book-entry alone, with no other formal requirements and no physical delivery of any evidentiary documents (although after the transfer the depository

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317 Section 2(3); and Vermaas (1997) *SA Merc LJ* 175; Vermaas (1996) *SA Merc LJ* 197 & 198; Vermaas *Dematerialisasie* 386.

318 Section 10. See also Blackman et al *Commentary* 5-205 – 5-206; Vermaas (1997) *SA Merc LJ* 171; Vermaas (1996) *SA Merc LJ* 207-209; and Vermaas *Dematerialisasie* 395-396.

319 Blackman et al *Commentary* 5-200; and Vermaas (1996) *SA Merc LJ* 198.

320 Section 8; and Vermaas (1996) *SA Merc LJ* 199 & Vermaas *Dematerialisasie* 188.

321 As above at § 3 2 1 2.

322 Blackman et al *Commentary* 5-205; and Vermaas (1997) *SA Merc LJ* 171-172.

institutions may have revoked old and issued new certificates, if necessary). The central securities depository accounted for the deposits of depository institutions by internal book-entry, and the latter similarly accounted for the holdings of their clients. To effect transfer the participant or participants (if they were different depository institutions) of the transferor and transferee effected transfer by book-entry, and the central securities depository (holding the certificates and being the nominee) effected an internal book-entry to reflect this. Naturally this presupposed a certain co-operation and communication between the various intermediaries.[323]

Thus the Act created a system of transfer by book-entry through what effectively amounts to the immobilisation of the dual instrument of *registered holdership* (i.e. certification and entry in the securities register), bringing it into line with the practices of other jurisdictions, and greatly reducing the administrative and paper-based burden of high transactional volumes on the Exchange.[324] The central securities depository could also in principle handle clearing and settlement.[325] At that stage, there was only one central securities depository – Central Depository Ltd – and a number of participating depository institutions (mainly banking institutions, including the Reserve Bank).[326] Yet the Act did, in principle, make provision for more than one central securities depository, as well as a variety of structures for such a depository.

Nonetheless in practice the single-depository system prevailed and Strate Limited, having eventually replaced or absorbed SASH, UNEXcor, Central Depository Ltd and STRATE Ltd,[327] remained the only central securities depository in South Africa. Yet at this stage, the Act's provisions remained empowering and "opt-in", and large volumes of securities were still held and traded on the paper-based system.[328]

What this section shows is that the immobilisation of debt and equity securities' certificates, driven by adaptations in the secondary market, illustrates a gradual (but to later legal development crucially important) shift in the legal role of the "instrument" dimension of securities as certificate coupled with register entry. Even before statutory intervention, legal policy was moving away from the primacy of the certificate (1) as a means through which the registered owner (as potentially distinct from the

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323 Blackman et al *Commentary* 5-205 – 5-206; Vermaas (1997) *SA Merc LJ* 171; Vermaas (1996) *SA Merc LJ* 200 & 209; Vermaas *Dematerialisasie* 388.

324 Blackman et al *Commentary* 5-206; Vermaas (1996) *SA Merc LJ* 200; and Vermaas *Dematerialisasie* 188.

325 Vermaas (1996) *SA Merc LJ* 204, 205 & n 92 & Vermaas *Dematerialisasie* 193.

326 See Vermaas (1996) *SA Merc LJ* 204, n 89.

327 See Chapter 2, § 2 3 2 and § 3 2 2 below.

328 See Blackman et al *Commentary* 5-207; Vermaas (1997) *SA Merc LJ* 42 & 44-45; Vermaas (1996) *SA Merc LJ* 204, 205, 209-210, n 118-119, and 211; Vermaas *Dematerialisasie* 193.

beneficial interest holder as per s 104 of the Companies Act of 1973) was able, practically,[329] to exercise her rights, and (2) as *prima facie* evidence of legal title. Issuers' securities registers thereafter began to become the main mechanism through which efficient trading was facilitated, with intermediaries (as registered owners) effecting the holding and transfer of immobilised securities.

Other evidentiary documentation was issued to beneficial interest holders to augment the immobilised and often globalised certificates. Via contractual, mandatory, agency, and nominee relationships with (and between) the various intermediaries, beneficial interest holders were able to enjoy the rights their securities afforded them without use or possession of the certificate or entry in the register. Statutory recognition and regulation of central depositories through the Safe Deposit of Securities Act intensified this policy shift, which was taken to its logical conclusion thereafter through dematerialisation.

3 2 3 Dematerialisation in South Africa

The final step in the modernising of South Africa's listed secondary market occurred in 1998 through the passing of two Acts. The Custody and Administration of Securities Act[330] amended much of the contents (and the title) of the Safe Deposit of Securities Act, most importantly incorporating into it provisions for uncertificated securities and enabling a system of participant *sub-registers*.[331] The Companies Second Amendment Act[332] introduced s 91A to the Companies Act of 1973 – dealing with uncertificated securities. Together, these Acts introduced uncertificated securities to South African law, using the existing framework of *central* deposit to implement the system.

The Stock Exchanges Control Act, the Custody and Administration of Securities Act and others were eventually consolidated into the Securities Services Act,[333] which was later (after the passage of the current Companies Act and the impact of the 2009 financial crisis) replaced by the Financial Markets Act.[334] In this way, the South African securities market was brought in line with a broader consensus

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329 For example, the certificate gained the holder access to shareholders' meetings and well as "standing" to cast a shareholder's vote.

330 38 of 1998.

331 See most importantly for example s 1(g), s 3A, s 8, and s 10(a) in terms of the first point, and Chapter 6 for the second.

332 60 of 1998.

333 See Chapter 2, § 2 3 2.

334 19 of 2012.

advocated by Lord Richardson's "Group of Thirty" reports[335] regarding efficiency, risk and paper-based problems in international securities market practices.

However, not all securities were simultaneously dematerialised, and it was only after the passing of the Securities Services Act that it was generally thought possible to dematerialise registered debt securities.[336] Until the merger of UNEXCor and Central Depository Ltd with STRATE in 2003,[337] debt securities trading on BESA remained immobilised with Central Securities Depository Ltd, and only began to be dematerialised after the passing of the Securities Services Act in 2004, via Strate. It will be shown below, in furtherance of the argument of a pronounced share-centricity in the approach of the legislature, that this occurred despite the fact that company debt securities were in all likelihood capable of dematerialisation at the same time as equities.

Lastly, certain money market *instruments* are subject to exchange trade, and therefore in a sense should be seen, rather, as money market *securities*. As will be shown, these money market securities were only dematerialised in 2009.

3 2 2 1 Dematerialisation in principle: s 91A & STRATE

In principle, Act 38 of 1998 (in conjunction with s 91A of the Companies Act) facilitated a system whereby *all* listed securities could be centrally deposited, whether in certificated or uncertificated form. By amending the Safe Deposit of Securities Act, it retained the empowering character of the legislation, as well as continuing to make provision for more than one central securities depository and for physical deposit of certificates as well as dematerialisation.[338] Thus the legislation made allowance for a parallel system of certificated and uncertificated collective and central deposit through various collective securities depository "participants" (i.e. intermediary depository institutions approved by the Registrar and accepted by the central securities depository).

The practical realisation of dematerialisation supports this although, as argued below, doing so on incorrect legal grounds. The JSE did not implement parallel forms of deposit, and the STRATE project,[339] initiated for the dematerialisation of shares, would make allowance only for uncertificated

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335 *Report on Clearance and Settlement Systems in the World's Securities Markets* (1989), and *Clearance and Settlement Systems: Status Reports* (1990).

336 See FR Malan & JT Pretorius "The reserve bank, banks and clearing houses in South African Law: part 2" (2001) 13 *SA Merc LJ* 163 173.

337 See Chapter 2, § 2 3 2.

338 See for example s 1 – "central securities depositor" (use of the indefinite article, also evident in s 12) & "deposit"; s 4(1)-(3A); s 8 or s 10(3).

339 For a detailed description of this, see M Vermaas "Dematerialisation of Listed Securities: A Synopsis of the Companies Second Amendment Act 60 of 1998" (1998) 10 *SA Merc LJ* 336 in §2.2, 337-338.

securities on the JSE,[340] or any other exchange making use of its services. Thus, on the JSE only equity securities were dematerialised. BESA, on the other hand, retained the services of Central Securities Depository Ltd (until the former and BESA's clearing and settlement house UNEXCor merged with STRATE Ltd to form Strate Limited in 2003) and only after the Securities Services Act was passed did it, via Strate, begin to dematerialise its securities.[341]

The newly inserted s 91A of the Companies Act was the centre-piece of dematerialisation. It applied only to "securities as defined in s 1 of the Stock Exchanges Control Act of 1985", which in both letter and spirit includes debt securities.[342] In essence, the provisions in the Companies Act dealing with the issue of certificates after allotment or transfer, the role of the instrument of transfer,[343] as well as provisions regarding the register of members[344] needed to be amended. This was because, within the existing framework of central deposit, dematerialisation required (among other more administrative or operational matters) three fundamental changes.[345]

The first was the replacement or augmentation of companies' registers of members as per s 105 (and, as discussed below, potentially also the register of debenture holders as per s 128) and securities transfer arrangements as per s 133, to make allowance for securities held in uncertificated form. For dematerialised securities, the book-entries of the depository institutions who were participants to a central securities depository, along with those of the central depository itself, would fulfil the function of (i.e. "become") the issuers' securities register. This was to ensure that a number of affected provisions in the Companies Act would remain workable and operative, for example ensuring that holders of dematerialised securities could remain members of the company in terms of s 103.

Yet, mainly as a result of the share-centricity of the Act, this was only partially achieved. Section 91A fell under the sub-heading "*Shares (s 91-91A)*". Subsection (3)(b) & (c) vested in participants the responsibility to maintain a "subregister".[346] The subregister would from part of the company's

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340 Vermaas (1998) *SA Merc LJ* 340.

341 For an excellent and more detailed discussion of the full import of the SSA, the dematerialisation of company securities, and the Companies Act 61 of 1973, see Blackman et al *Commentary* 5-206 – 5-238-1.

342 Section 91A(1) as quoted above.

343 Specifically s 96(1), 140(1) and 133(2).

344 Such as s 103, 104, 106, 109, 110, 113, 114 and most importantly for these purposes s 128; as well as s 133.

345 Other more general factors or characteristics required for implementation include simplicity of transfer; accountable and integrated legal development; cost-effectiveness; technological aptitude and feasibility; and the co-operation and support of all relevant stakeholders – see Vermaas (1997) *SA Merc LJ* 180 & Vermaas (1998) *SA Merc LJ* 337.

346 I.e. "the record of uncertificated securities administered and maintained by a participant, which forms part of the relevant company's register of members as referred to in this Act…" – s 91A(c).

members' register and contain the same details as required by sections 105 and 133, whilst ss (4)(d) nullified the application of s 133 to uncertificated securities.

Crucially, the new section was silent on the matter of the register of debentures as required by s 128. Moreover, in Act 38 of 1998 "'uncertificated securities'…means uncertificated securities as defined in section 91 of the Companies Act…", which made s 91A the operative provision. As is clear, apart from the definition of securities, no arrangements for the dematerialisation of debt securities were made. As discussed, the dominant view at the time was that debt securities could not be dematerialised. These securities, as well as government securities (including money market securities) not subject to the Companies Act's provisions, continued to be immobilised until the mid-2000s for BESA by Central Securities Depository Ltd, and later Strate Ltd, in accordance with this view.

This view may not have been correct.

First, consider s 91A(c): "'uncertificated securities' means *securities* as defined in section 1 of the Stock Exchanges Control Act…*which* are by virtue of this section transferable without a written instrument and are not evidenced by a certificate" (own emphasis). Thus, s 91A appropriated *its* (operative) definition of securities from the Stock Exchanges Control Act, which included debt securities. It further stipulated that (ostensibly *any*) such "securities" may have been transferred and evidenced without any documentary instruments.

Second, apart from its title and contextual placing in the Companies Act, s 91A made no explicit reference to shares, only to securities.

Third, and most importantly, in terms of s 91A(2), the section applied "(a)…notwithstanding any provision to the contrary contained in this Act or in any other law, the common law, an agreement or any articles…" and further stated that "(b) [w]here any provision of this Act is not expressly or impliedly amended by this section, this Act shall apply in respect of uncertificated securities in the same manner as it applies to securities in certificated form." Fourth, the memorandum to the Companies Second Amendment Bill unequivocally provided that "s 91A will apply to uncertificated securities and will regulate uncertificated securities notwithstanding anything to the contrary in any law, [or] the common law…except to the extent that [the Companies Act's] provisions are not expressly or impliedly amended by s 91A…". Fifth, nothing in the Custody and Administration of Securities Act prevented or seemed to exclude debt securities from the dematerialisation process.

In keeping with some of the conclusions of § 3 1 3, the share-centric structure of the Act appears to have made it difficult to give effect to the full ambit of s 91A, which is the dematerialisation of equity *and* debt company securities. Nonetheless, in light of the reasons set out above – most importantly the wording of s 91A(2)(b) – a very plausible interpretation of the section seems to suggest that debt securities were capable of dematerialisation from the moment s 91A became operative.

Nothing in Act 38 of 1998 or the Stock Exchanges Control Act prevented listed debt securities from being accounted for in depositories' *registers* or participants' *subregisters.* If so, by virtue of s 91A(2)(b), holdings of debt securities in the register and subregister could either have been read as being part of the register of debenture holders, or could simply have formed part of the members' register, as in the case of dematerialised equities. As is argued in the next section, it seems that the more compelling reason for the persistence of the immobilisation of debt securities is a function of (1) the systemically risk-averse stance of financial institutions and listed companies in terms of compliance with the law, and (2) the relative unimportance of company debt securities in the overall composition of the debt market.[347]

The second fundamental change to the Act required for the effective implementation of dematerialisation was altering the requirement that all securities have physical certificates and that they must be transferred by physical instruments of transfer (along with the destruction and issue of the old and new certificates respectively). Section 91A, as read with the Custody and Administration of Securities Act, effectively implements this change by nullifying these requirements in the Companies Act, but (expressly) only in so far as what might be termed "s 91A securities". This seems to have been read to refer to equity securities, but in all probability it could also have been read to have "impliedly amended" s 128 of the Act as well.

Lastly, measures had to be implemented to improve security of transfer - i.e. to protect *bona fide* acquirers of uncertificated securities where a transaction was tainted by some fraud or illegality, as well as to shield other market participants from potential abuse.

3 2 2 2 The subsequent dematerialisation of debt securities

It has been argued above that company debt securities could have been dematerialised from as early as 1998 onwards, yet such dematerialisation occurred only gradually after 2004. After the 2003 merger of UNEXCor and STRATE (into a rebranded Strate Ltd), and the merger of BESA and the JSE in 2009, the system was uniform, stable and largely similar to what it is today.

The Securities Services Act (SSA) defines uncertificated securities in s 29 (Chapter IV – "Custody and Administration of Securities") as follows: "securities that are not evidenced by a certificate or written instrument and are transferable by entry without a written instrument". The SSA continues to

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[347] See Chapter 2, § 2 3 2.

recognise that securities may be held in central deposit in certificated or uncertificated form and made provision for both dematerialisation and immobilisation.[348] Yet its definition of uncertificated securities no longer relies on the definition of s 91A of the Companies Act. On the contrary, the SSA substitutes the definition of both uncertificated and certificated securities found in s 91A, so as to refer to *its* definition (s 29). Thus the operative definition for uncertificated securities reads "uncertificated securities as defined in section 29 of the Securities Services Act, 2004, which are entered in the relevant company's *register of members* as uncertificated securities in terms of subsection (3)*(a)*".[349]

As far as company securities were concerned, s 91A(2) remained in substance unchanged, and no overall change to the Companies Act regarding the debenture holders' register was effected. Therefore, whilst making the legal position slightly more explicit, these legislative changes in all likelihood did not newly empower the dematerialisation of company debt securities. The definition of "securities" in s 1 of the SSA is materially the same as its predecessor in the Stock Exchanges Control Act. The only meaningful change, which seemingly allayed the prior risk-aversion of market participants to an interpretation inclusive of debt securities, was the change in operative definition from that of the Companies Act to that of the SSA.

It is in fact more likely that institutional risk appetite was the reason for the delay in the dematerialisation of debt securities. The then-prevalent legal view of the ambit of provision for dematerialisation was, though contestable, not totally unjustifiable, and the systemic financial risk of an interpretation which is somewhat contestable is an understandable incentive to act with caution and keep debt securities immobilised. The trading volume and velocity of debt securities (which even today remains mainly between large institutional buyers and sellers) also did not present the same pressing need for a paperless solution.

Thereafter, finally, after the passing of the Companies Act of 2008 and the Financial Markets Act of 2012 as the SSA's successor (in part a response to the effects of the 2009 financial crisis), the secondary market's legal regime has remained unchanged. By 2012, 98% of all listed debt securities had been effectively dematerialised.[350] No doubt there are little to no immobilised domestically issued securities in today's market.

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348 Compare for example s 33(h) and (i); see also Blackman et al *Commentary* 5-209.

349 Own emphasis – even after this change, there was still no reference to the register of debentures mandated by s 128.

350 Strate "98% of SA's R1,15 Trillion in Bond Market Assets Now Dematerialised" (08-02-2012) *Strate Press Release* <http://www.strate.co.za/press-release/98-sa%E2%80%99s-r115-trillion-bond-market-assets-now-dematerialised> (last accessed 27-02-2015; regrettably the link now appears defunct).

Nonetheless the true significance of the SSA was that the dematerialisation of *all* debt securities was achievable, simply because dematerialisation became possible on the basis of the definitional schema of the SSA alone and without the need for s 91A. This was particularly important to the dematerialisation of non-company securities such as Treasury Bonds or municipal debentures, as the above figures illustrate well.

The last issue that needs to be discussed is the dematerialisation of money market instruments in order to make use of some or all of the elements of the trading infrastructure of equities and more traditional debt securities. This is in particular relation to the custody and administration of securities as provided for by the various iterative versions of South African securities depository legislation. These particular money market instruments only began to be issued in dematerialised form in 2009, and no existing instruments were subsequently dematerialised.[351] These instruments were not listed on the Exchange at that time.[352]

There are two important aspects to these instruments, which include: commercial paper, shorter-term Treasury and Reserve Bank debts, or certificates of deposit (negotiable or otherwise – better known as "CDs" or "NCDs"). Here two important preliminary points must be made.

First, many of these instruments were issued *to bearer*. Accordingly, before the advent of their dematerialisation, if it was necessary to integrate any such instrument into the pre-existing market trading architecture (specifically the custody and administration, including clearing and settlement, services of STRATE and later Strate), it could simply be physically deposited at a central depository, and thereafter function as "deposited" registered securities. Those not issued to bearer could be dealt with by the depositary system as registered securities *ab initio*.

Second, any such money market *instruments* actually become money market *securities*. This is clearly evident from a number of observations. First, the SSA's definition of "securities" in s 1 explicitly excludes money market instruments save for the purposes of Chapter IV of the Act ("Custody and Administration of Securities"), where a secondary definitional provision in s 29 includes these instruments as securities.

Second, the Explanatory Memorandum on the Financial Markets Bill makes this terminological division abundantly clear. Explaining a change from the term "money market instruments" (as used in the SSA) with "money market securities" in s 1 *v.* "securities", the memorandum states:[353]

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351 See Chapter 1, § 1 1.

352 National Treasury, *Explanatory Memorandum on the Financial Markets Bill, 2012* (April 2012) 18.

353 Treasury, *Explanatory Memorandum* (2012) 17 [own emphasis], see also 33-34.

> "The definition has been amended to correct an error by replacing the reference to money market instruments with a reference to money market securities. *This is aimed at distinguishing money market instruments from money market securities,* and to align with the definition of "securities" which expressly "excludes money market securities from the definition except for purposes of the custody, administration and settlement chapter of the FMA."

Further, the exact same change is brought about for s 1 *v.* "issuers", together with the following commentary:[354]

> "This definition has been amended to correctly refer to money market securities. The aim is to limit the scope of the FMA to money markets securities only."

Lastly, and quite usefully, there is the inclusion of a definition in s 1 for "money market securities", on which the memorandum reads:[355]

> "The purpose of the definition is to clearly define the term as meaning money market *instruments that are uncertificated securities* reflected in an uncertificated securities register."

This makes it clear that once a money market instrument is subject to the custody and administration mechanisms of the securities market, it comes to be regarded as a security.

From 2009 onwards, money market *securities* begun to be issued in dematerialised form. It is unclear why this only occurred at this stage. Nevertheless, it does greatly reduce the complexity of the analysis in the rest of this work, as all uncertificated securities in South Africa therefore function as *registered* (uncertificated) securities. With this final step all debt securities in South Africa were capable of being issued in dematerialised form, and the historic portion of this work ends here. The following three chapters, informed by the outcomes of Chapters 2 and 3, deal only with currently contemporary issues in forming a theoretical framework which can then be tested against some of those issues in Part 2.

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354 Treasury, *Explanatory Memorandum* (2012) 13-14.

355 Treasury, *Explanatory Memorandum* (2012) 14 [own emphasis].

CHAPTER 4

4 Deconstructing the (debt) security

In keeping with the broader methodological approach outlined in Chapter 1, these three final chapters of Part 1 attempt to explain debt securities using an analytical-systemic approach. This approach is centred around how the debt security "fits into the overall scheme of private law…" (but also in this context commercial law) and is primarily concerned with "'legal dogmatics', and…the analysis of concepts and their systemisation".[1]

To do so, the result of these chapters must accomplish three things. First it must provide a manner in which to identify and give a discrete legal meaning to the securities concept within the broader realm of financial instruments. Second it must explain, within the legal system in which these securities function, how securities are structured, how they originate, and what the legal dynamics between issuer, holders, and third party interest holders are. Third it must enable one to derive from this a holistically consistent working theory of the legal nature and dynamics of debt instruments specifically.

In order to solve most of the problems surrounding debt securities, the securities-concept outlined in Chapter 3 is the key. As is clear from what follows, the predominant focus of the rest of this work is on understanding certain broader legal problems regarding *securities at large*. This is what facilitates a clear exposition of the nature and classification of debt securities in particular.

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[1] See DV Cowen & L Gering *The Law of Negotiable Instruments in South Africa: Volume 1* 5 ed (1985) 11.

Within the analytic-systemic evaluation, this chapter and the next focus on the second and third problems above, looking at financial instruments which are uncontentiously classified, or classifiable, as securities. Chapter 6 completes, with the benefit of the outcomes of these two chapters, the overall analytical-systemic discussion by dealing with the first above-mentioned problem – establishing a methodology through which greater certainty regarding the classification, or classifiability, of phenomena as "securities" is achievable. In that regard it must perhaps be noted here that Chapter 6 slightly exceeds the scope of the rest of this work, dealing not only with registered securities, but also attempting to come to classificatory terms with the broader securities concept as found in South African law.

The term "debt security" (including the more opaque "debt instrument" referred to in the Companies Act)[2] refers to securities originating from borrower-lender arrangements. Despite this, the more cogent distinction is between equity securities and other securities. This is because the latter group has one central characteristic in common: the primary, foundational components of the underlying legal interest arise *contractually*.[3] Thus, as a point of departure, most conclusions drawn about the fundamentals of debt securities ought to apply equally to any registered security.

Importantly, once a financial arrangement bestows on a particular party or parties a legal interest which is classified – or classifiable – as a "security", the content of that legal interest may expand. As a security, the underlying interest also includes *other* rights and competencies[4] which arise *consequentially.* This is because, as a security, the positive law attaches additional content and consequences to that legal interest. This chapter will only draw conclusions regarding cases where classification is uncontentious and thus any reference to securities' *underlying interest* is a reference to the (consequentially expanded) totality of rights and other competencies bestowed by securities.

This chapter will outline the foundations of a general theory of (debt) securities and is primarily concerned with the legal nature and form of securities in South African law. However, not all the conclusions drawn here are readily transposable to *uncertificated* securities. Therefore, the following chapter will deal, as briefly as is possible, with the requisite adaptations to the foundation laid out here, as required to come to a similar understanding of uncertificated securities.

This chapter consists of three parts.

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2 See section 43 of the Act, 71 of 2008 (hereafter merely the "Companies Act" or "Companies Act of 2008").

3 See § 4 2 below, and Chapter 6, § 6 3 2.

4 I.e. those benefits or other aspects of the underlying interest which cannot easily or uncontentiously be characterised as personal rights in the strict sense. The chosen term, "competency", is thus meant to encompass all other terms such as "entitlement", "capacity", "power", non-subjective "right", or "privilege". For example, in the context of company securities specifically, "*competencies*" such as voting "rights" or statutory remedial "rights" illustrate the point. See also Chapter 6, § 6 3 2.

The first part deals with the underlying structure of securities. Specifically, it focuses on the internal architecture of securities and the various legal relationships that are created thereby. It is, in its essence, a re-conceptualisation of the traditional legal distinction between so-called registered and beneficial "ownership" inherent in the structure of modern South African securities. Primarily, it attempts to unify and more accurately describe the principles of the positive law that have coalesced around securities, and do so in a way that better harmonises the doctrinal incongruities resulting from the imperfect reception of this construct from English law.[5]

To that end, it is argued that all securities are comprised of two interdependent, but functionally separate,[6] *legal objects*. The first construct is referred to as the "security instrument". In essence, it is a *locus for (holdership of) the incidents*[7] *of execution* over the underlying interest in a security. It typically manifests as entry of the instrument-holder into the securities register and the issue to that holder of a security certificate; or, in the case of uncertificated securities, merely electronic register entry in the uncertificated securities register. The section argues that the so-called registered rights, which accrue to a registered holder of a security, should rather be understood as *incidents of execution*, severed from the totality of the underlying interest in securities.

Second is what will be called the "security asset". It generally corresponds with the proprietary dimension ascribed by the law to a security – i.e. patrimony as the economic end-benefits of the rights and other competencies contained in a security.[8] It, in turn, is the *locus for (holdership of) the incidents which remain* after the incidents of execution have been shorn from the underlying interest.

The second section below discusses the creation of securities, and the meaning of "issue". It deals broadly with how securities come into existence, the foundational importance of an allocation of the ability to *realise and enforce* the benefits of the underlying interest (styled from this point forward as "execution"), and also incidentally illustrates the importance of the classificatory problem of Chapter 6 in the context of contractual securities. The third and final section discusses certain core proprietary features of security-*holdership*, analysing these features through the outcomes of the re-conceptualisation of securities' underlying structure.

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5 See Chapter 3, § 3 1 for a full account of the English law influence on this area of South African law.

6 As mentioned in Chapter 1, this interdependent separateness is not to be confused with the full separation and severability of "registered ownership" and "beneficial ownership" as advocated in JL Yeats, R de la Harpe, R Jooste, H Stoop, R Cassim, J Seligmann, L Kent, R Bradstreet, RC Williams, MF Cassim, E Swanepoel, FHI Cassim & K Jarvis (2018) *Commentary on the Companies Act of 2008*. This will become through the totality of this Chapter and the next.

7 See § 4 1 below for an explanation of how the notion of these incidents fits into the overall South African legal system.

8 This is, of course, traditionally referred to as the beneficial interest.

In Part 2 of this work, using a functional-policy framework, it remains to be shown that the conclusions of this and the following two chapters have demonstrable problem-solving qualities which lead to a more cogent and functional statement of the law in its current form.

4 1 A re-conceptualisation of the underlying structure of securities

Securities are very complex constructs in terms of the law, and the deeper foundational attributes of securities appear to have been largely glossed over in past legal research and practice. By identifying the commonalities that are exhibited by the broad spectrum of modern securities, one can draw together all applicable legal rules and principles, found in various branches of the positive law, that deal with those commonalities. From this, a uniform account of the nature and form of securities in South African law emerges – one which, because it is in harmony with the underlying structure of South Africa's mixed-law heritage and its Civilian private law, potentially resolves a number of lasting legal problems.[9]

In South African law, securities have developed over time into a very specific form. This development begins with the grouping of shares and certain configurations of debt as *securities* in the mid- to late-20th century. It will be argued that the law's development in this regard has already implicitly converged upon an archetype of securities that includes an interdependent set of constructs: the security asset and the security instrument.[10]

A typical security will contain multiple rights, which is why securities can, at least in South African law, be characterised as "bundles" of personal rights. This kind of language was first applied only to equities (i.e. shares)[11] – but is now justifiably applicable to most modern securities.[12] However, even this is an over-simplification. First, the underlying interest of which securities are comprised is in fact

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9 See Part 2 of this work. .

10 This is, largely, due to the utility of certain attributes of registered securities in the dematerialisation of securities in legal systems which are influenced in this regard by English law. See Chapter 3 generally, and § 3 2 for this development. More generally, the law also appears to have casuistically assimilated a number of similar (more recently emerging) financial instruments into some of its statutory securities concepts – see Chapter 6.

The traditional notions of registered title and beneficial ownership appear to be have been retained in South African company law after that passage of the Companies Act 71 of 2008 – see as best discussed in Yeats et al *Commentary 2008* 2-670 – 2-672, discussing therein also specifically *Kruger Investments Group Limited v Nuberry Holdings Limited* (unreported, WCC case no 14184/15, [2015] ZAWCHC 159, 30 October 2015), *Du Plooy NO v De Hollandsche Molen Share Block Ltd* 2017 (3) SA 274 (WCC), and *Monique Investments (Pty) Ltd v 167 Bree Street Newtown (Pty) Ltd* (unreported, GJ case no 2014/3306, [2015] ZAGPJHC 232, 10 April 2015) as supportive of the continued distinction between these two forms of holdership. See also Yeats et al *Commentary 2008* at 2-676.

11 See for instance PJ Sutherland & AJ Van der Walt "Dispossession of incorporeals or rights – is the mandament van spolie the appropriate remedy?" (2003) 15 *South African Mercantile Law Journal* 95 96 (and various authorities cited therein).

12 "Securities represent bundles of rights against a company" – K Van der Linde & S Lutz "Aspects of the cross-listing of securities" (2009) 21 *South African Mercantile Law Journal* 631 631 & n 1.

typically a complex combination of personal rights (created *inter partes* by issuers and primary market acquirers)[13] *and* other rights and competencies that arise consequentially through such a legal interest being classified as a security.[14]

Second, it appears from the South African positive law that these constituent parts of the underlying interest can be subjected to an even deeper analysis. Shortly, personal rights can be described in terms of subsidiary *incidents*, flowing from the so-called two-fold components of the creditor's interest (*komponente van die skuldeisersbelang*).[15] Over and above obligationary content, securities' *ex lege* competencies (which do not fit easily into a subjective rights paradigm, but certainly create at least subjective relationships) can be subjected to a materially similar analysis.

In order to frame this analysis, and in so doing formulate a point of departure, securities' place in the vast, multi-layered system of positive law must be properly understood. Whilst somewhat abstract, this point is crucial to understanding the unique, and unorthodox, legal nature of these assets in the South African legal system. In this legal system securities are bundles of personal rights and other positive law competencies. It follows that the underlying interest gives rise to complex sets of horizontal legal relationships. Most important are those between issuer, asset- and instrument-holders, but this also includes those arising between these parties and third parties.

Securities also constitute "property" in their bestowing, *inter alia*, of personal rights and competencies (operative against the issuer) upon their holders. This illustrates that the content of a security has a marked subjective rights (somewhat better captured in Afrikaans as *subjektiefregtelike*) dimensionality. Yet the doctrine of subjective rights, and specifically its five-fold classification of subjective-right categories, is of very limited use in the analysis of securities. Its central weakness lies in its tendency to degrade into conceptualist legal thinking and dogmatics (*Begriffsjurisprudenz*), inadequately accounting for legal phenomena which do not conform to its doctrinal contours.

Nonetheless, the broader *paradigm* of the doctrine does have a degree of value in formulating a point of departure. This value is found in understanding where subjective rights lie within the positive law, so that its sphere of influence with reference to *securities* can be understood in this larger system of law. Central to the concept of this so-called system of subjective rights is, for better or worse, what it seeks to achieve. Here H Dooyeweerd's proposition "*de beschikkings- en genotsbevoegdheid…als noodwendige momenten in ieder subjectief recht, dienen in den zin van*

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13 See § 4 2 below.

14 See § 4 1 2 and § 4 2.

15 These being the so-called entitlements of determination and enjoyment (i.e. *beskikkings-* and *genotsbevoegdheid*) – GF Lubbe "Sessie in securitatem debiti en die komponente van die skuldeisersbelang" (1989) 52 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 485.

het 'juridisch' wils- en belangenbegrip te worden gevat"[16] is a very useful articulation. It reveals that the higher order function of subjective rights within the broader legal system is the "*ewewigtige harmonisering van 'n veelvuldigheid van belange*",[17] in so far as they exist horizontally between legal subjects.

This deeper subject-subject legal order which subjective rights aim to bring about is primarily premised on the legal subject-*object* relationship. This is because, as per Dooyeweerd, moments of volition and instances of interest amongst legal subjects collide with reference to objects – entities or phenomena which have *use.*[18] The reading of the determination and enjoyment (*beskikkings-* and *genots-*) entitlements into the subject-(useful)object relationship facilitates a delimitation (*afbakening*) of competing social and economic interests and wants, as they arise relative to useful objects.[19]

Thus the dual-entitlement construct of private law rights is the black-letter, doctrinal product of a more abstract (and developmentally dynamic) policy position on the discounting of competing horizontal interests, in furtherance of the social order and cohesion. Furthermore, regardless of the subjective right in question, this ring-fencing of interests through these dual entitlements *must*, in this light, be seen on some level as operating *erga omnes*. This is an oft overlooked aspect of the discourse surrounding personal rights in particular and is important in the context of securities as proprietary, wealth-storing "assets".

Nonetheless, it is insufficient to state that the subject-*subject* dynamic is "*so vanselfsprekend van die subjektiewe reg as die bestaan van die reg as samelewingsorde*".[20] As accurately perceived by AJ van der Walt, there are aspects to horizontal legal interactions which do not relate to substantive, subjective rights as such, and a recognition of (other) "subjective relationships" is necessary to "offer an acceptable explanation of the existence and protection of subjective relationships which are not subjective rights".[21] This results in a slightly wider, but better defined, circumscription of the sphere

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16 Loosely: "[t]he entitlements of determination and enjoyment…as necessary occurrences in every subjective right, serve the purpose of capturing [or perhaps better translated as *discounting*] the will and interest concepts" – H Dooyeweerd "Grondproblemen in de leer der rechtspersoonlijkheid" (1937) 98 *Themis* 199 & 367 409.

See also WA Joubert "Die realiteit van die subjektiewe reg en die betekenis van 'n realistiese begrip daarvan vir die privaatreg" (1958) *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 12 (Part 1) & 98 (Part 2), 110 (generally also 100-111), FJ van Zyl & JD Van der Vyver *Inleiding tot die regswetenskap* (1982) 412-417, Lubbe (1989) *THRHR* 495 & n 59.

17 I.e. the "equilibrious harmonising of a multitude of interests" – Joubert (1958) *THRHR* 110.

18 See § 4 3 2 below, specifically with reference to Van Zyl and Van der Vvyer's view of the definition of "legal object" as dealt with therein.

19 Joubert (1958) *THRHR* 104-112 & 114, § F "(2)" and "(3)".

20 Joubert (1958) *THRHR* 114, § F "(1)"

21 AJ van der Walt "The doctrine of subjective rights: a critical reappraisal from the fringes of property law" (1990) 53 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 316 325 (§ 4).

of the subjective – as "private law rights *and* relationships". Consequently, it generates a better understanding of the outer-limits, or *ambit*, of its operative paradigm within the positive law.

Within the broader framework of the South African law, this sphere of systematised concepts, "*geleë aan die subjeksy van die reg,* staan selfstandig teenoor die reg as norm, maar sy inhoud word deur die regsnorme gereguleer*…(die regsnorme bepaal nl. die grense van die reghebbende se beskikking en genot van sy regsobjek).*"[22] This statement, in particular the parenthesis, is key to understanding the legal nature of securities. Securities are *not* a phenomenon of "private law rights and relationships". Securities exist, instead, as a consequence of the *interaction* between private law rights and relationships and the objective law. Thus, for the purposes of a juridical model of their legal dynamics, one must accept that securities: (1) cannot be adequately accounted for in terms of the dual subjective entitlements of determination and enjoyment; and (2) must instead be explained within the sphere of interaction between the horizontal, subjective legal order and the objective law – i.e. in terms of the legal *incidents* this interaction gives rise to.

This statement needs to be briefly unpacked. Securities' existence is a result of: (1) how legal norms determine the boundaries of the determination and enjoyment entitlements of the security-as-object;[23] (2) what legal subjects choose, through juristic acts, to do with those entitlements *inter se*; and (3) the superordinate topography of the objective law (most notably, in the case of securities, statutory effects).

It should be clear that in the case of a personal right, the entitlements of determination and enjoyment are *the* two "components of the creditor's interest". However, as a result of those components' interaction with legal subjects and the objective law, they can be said to have a far greater number of *functionalities.* This is what is meant by *incidents* in this work. This view is not uncontentious. GF Lubbe, relying to some extent on TK Pahl,[24] appears to support this view, and its simpler two-fold construction of the content of personal rights. In opposition to the German law-influenced view of personal rights as "*'n bondel bevoegdhede*", he states that:[25]

> "*[d]ie feit dat 'n skuldenaar op verskillende wyses deur middel van regshandelinge oor die reg kan beskik, beteken nie dat daar ooreenkomstige bevoegdhede is wat deel uitmaak van sy juridiese arsenaal nie…*[Pahl's view] *is myns insiens te verkies bo 'n benadering wat die beskikkingsbevoegdheid verwar met*

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22 Joubert (1958) *THRHR* 115, § F "(5)" [own emphasis].

23 Or, stated conversely, the limit of the lawful consequences that juristic acts, flowing from holdership of these entitlements, can bring about.

24 TK Pahl *Die aanwending van vorderingsregte ter versekering van skulde* (1972) 164-166 & 176.

25 Lubbe (1989) *THRHR* 493-494.

> *'n spektrum van regshandelinge wat die regstelsel erken ten einde aan die behoeftes van partye in die regsverkeer te voldoen.*"

Yet in a more recent work, Lubbe appears to take a contrasting view. In explaining the right of the cessionary and cedent *in securitatem debiti* on the pledge construction as the right, he states:[26]

> "There is authority for the view that the cession vests only a limited right in the debtor's performance, namely 'the exclusive right to claim and receive…the amounts owing', in the cessionary. This enables the cessionary to hold rather than own the debtor's performance and provides a basis for the recognition of a real right of pledge in the debtor's performance for the cessionary.
>
> [From here on in n 19:] This reflects a construction, adopted and adapted from German precepts…based on an analysis of the characteristics of the personal right which forms the subject matter of the security…A claim, so it is reasoned, *confers* on the holder of the right not only the capacity and hence the *locus standi* to exact performance (to collect interest, in the case of a money debt, and capital once the claim has matured) *but also a variety of other functions*, such as the capacity to alienate, waive, novate or renew it, to cancel the transaction giving rise to it, to vote or claim a preference where the right carries such a privilege, to apply for the debtor's sequestration, to take advantage of a lien or suretyship, and so forth."

The former view is preferred. Firstly, its supporting arguments appear more coherent. Second, and more importantly, it is not necessarily incompatible with the latter view. An accurate understanding of the paradigmatic *ambit* of private law rights and relationships reveals that holdership of a claim, or set of claims, to performance (i.e. holdership of these two core entitlements or "*bevoegdhede*") does indeed result in these multitudinous functionalities, but not on the isolated level of the subjective, private law (i.e. not as the content of a subjective right). Instead these functions, or rather incidents, are a result of the *interaction between* (1) the twofold content of private law rights, and (2) what the contours of the objective law allow legal subjects to do. Most importantly for present purposes, *that* is the level on which they must be understood and analysed: where the holders' relationship to the legal object meets what the objective law does and does not countenance or enable in the doings of legal subjects.

Thus the incidents of holdership of a personal right are not juridically to be found at the level of private law rights and relationships. These features reside instead on what can be termed a "mezzanine" juridical plane at the intersection between the subjective and objective law – the level of the interaction of the former and latter, put in motion by the exercise of legal subjectivity. Because this juridical plane is an intersection, its content will depend on both the content of the subjective law below it and the objective law above it, as they interact through juristic acts. So it is to be seen, for example, that a usufructary may pledge her *usus* and *fructus* to third party, but may not dispose of

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[26] GF Lubbe "Cession" in WA Joubert (ed) *Law of South Africa* Vol 3 (3 ed) 2013 § 180 & n 19 [own emphasis].

the patrimonial object her rights derive from; conversely the *usufruct*-giver may dispose of the patrimonial object, but not pledge its *usus* or *fructus.* These are legal dynamics the doctrine of subjective rights cannot, in isolation on its purely horizontal juridical plane, adequately account for.

Securities are a phenomenon of mercantile or commercial law. The critical feature of this area of law is that much of its legal mechanics can be described as arising at this mezzanine juridical intersection of legal subjectivity and objectivity. In a sense, mercantile-commercial law exists as a kind of "*applied* private law", and the qualifier drives the point home. Its emergent black letter content is more fluid and less bound by doctrine, constantly being modified by interaction with statute and other emergent positive law principles, as well as the commercial reality. Its development is fundamentally *reactive*. In the Dworkinian sense, the black letter results of this process of principle and policy discounting are driven by a uniquely commercial policy-mix of norms and imperatives, in which exigency often outweighs legal dogmatics. Thus R Goode is undoubtedly correct, first in describing "commercial law as the totality of the law's *response* to the needs and practices of the mercantile community…adapting itself constantly to new business procedures, new instruments, new demands",[27] and second in formulating the essence of the "philosophical foundations of commercial law" as a constant tension between the courts' pursuit of fairness and justice (on the one hand), and the business community's expectations of reasonable, predictable, and yet also responsive and dynamic legal results within a fundamentally flexible legal environment (on the other).[28]

This is the theoretical framework, or point of departure, that is necessary to fully account for securities' legal nature with jurisprudential consistency and integrity. Excessive peering at the purely private law rights and relationships dimension of this legal phenomenon hampers, rather than improves, the analysis. Similarly, although securities are not purely subjective phenomena of law, any analysis would be incomplete without an understanding of the underlying legal interest's subjective rights dimensions.

A robust and coherent exposition of securities' operative legal dynamics must be developed with reference to these mezzanine juridical effects. Thus, securities can only truly be theoretically accounted for in terms of the modalities of their *incidents*, as these incidents (as interactive functionalities of the underlying interest) are what is determinative of their legal nature.

It is shown below that, as a bundle of rights and competencies, the positive law in certain cases takes cognisance of the security holistically, not its individual rights and competencies. This allows the sum of its individual incidents – i.e. the global underlying interest – to be split holistically, so that

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27 R Goode *Commercial Law* 3 ed (2004) 1204 [own emphasis].

28 Goode *Commercial Law* 1204-1205. Here Goode also cites this tension as the reason commercial law favours supple principles over an abundance of technical rules.

all incidents related to *execution of the rights and other competencies* are located in (and held through) an "instrument". This is the abstract vessel (typically manifesting as entry on a securities register and the issue of an evidentiary certificate; or entry on an uncertificated securities register) to which these aforementioned incidents of execution accrue vis-à-vis its holder. This is also why it is described here as a locus for the (holdership of) the incidents of execution of the underlying interest. It will be shown that these incidents are derived from an aggregated entitlement of determination (*beskikkingsbevoegdheid*), gleaned from each right and other competency within the security but approached as a single, gobal entitlement with reference to the total, "bundled" content of that *security*.

What remains of the underlying interest is the "asset" component of a security, primarily conferring patrimony (but also, or perhaps including, the end benefits of its other competencies) on its holder. The asset is a refinement and extension of the notion that "[securities] are movable property".[29] It is the totality of patrimonial consequences – i.e. the end economic benefits – of the rights and other competencies of a given security, devoid of all incidents of execution operative against the issuer.

The distinction between the "beneficial interest" and the "registered rights" of shares is not a novel concept,[30] and merely extending this characterisation to all securities is also not in itself a great leap forward. Nevertheless, the re-conceptualising of securities as being, in terms of their incidents, structurally dichotomous *ab initio* does take matters forward. Ultimately, implying that a security asset (the refinement and extension of the notion of beneficial interest) and the security instrument (the refinement and extension of the notion of registered rights) are *separate yet interdependent*

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29 This formulation is found in s 35(1) of the Companies Act of 2008, and does not refer to "securities", but instead to "shares". However, it is submitted that, being the same confirmation of the common law as was found in this provision's predecessors, the common law principle which it confirms (that a company's underlying immovable assets do not render its securities immovable) applies equally to debt securities as contemplated in s 43, certain options as contemplated in s 42, and indeed any securities in such a context.

30 Although this chapter is to some degree at odds with the exact foundation for the position taken by Yeats et al *Commentary 2008*, the following is useful, at 2-571:

> "Traditionally, it has been the policy of the law that generally, a company only has regard to the registered holder of the securities (because the holder was the legal owner under English law) and hence the nominee's relationship to the company is no different from that of a registered holder that owns the rights attaching to the securities. Accordingly, where there is a nominee, the company looks only to the nominee and not to the beneficial owner. The traditional position is based on s 104 of the 1973 Act and its comparable predecessors and the related common-law jurisprudence; however, there is no comparable provision in the Act. Further, s 57(1) has somewhat blurred the distinction between 'registered title' and 'beneficial ownership'. As a result, there is uncertainty as to the position between the issuer company and a beneficial owner. Nevertheless, it would appear from s 56(8) to (11) that generally the separation of registered title and 'beneficial ownership' and 'interests' in the pre-existing related jurisprudence continues to have application and this is assumed to be the case for the purposes of these notes. This is supported by the recent cases confirming the separation of ownership and registered title and that only the registered shareholders are entitled to claim access to information in terms of s 26(1)… This conclusion is supported by the decision in *Von Siebel v Accentuate Limited* [2015] JDR 1182 (GJ), confirming that an undisclosed (in terms of s 56 of the Companies Act) asset-holder of uncertificated securities requires a proxy or appointment in terms of s 57(5) in order to attend and vote at a shareholders' meeting]."

See also Yeats et al *Commentary 2008* 2-669 – 2-672, specifically stating at 2-672 that "the right to be on the securities register continues to be determined distinctly from the ownership of the securities and, by implication, registered title continues to remain a distinct form of title, vesting rights in the registered holder."

legal objects subject to different forms of holdership is merely following this traditional distinction, as evidenced by legal developments in the positive law, to a logical and doctrinally sound conclusion.

Thus, the discussion below will be, to some degree, informed by the doctrine of subjective rights,[31] as this is necessary to understand the architecture (and consequences) of securities' underlying interest on the level of its incident-functionalities. However, it should not go without saying that during the analysis the doctrine in isolation quickly, in a sense, breaks down and loses its explanatory value.

4 1 1 Terminological and foundational concepts

Before a justification and explanation of the security asset and instrument can be made, certain foundational and terminological concepts must be set out.

As stated in Chapter 1, the distinction between securities that are to bearer and those that are registered informs the majority of this work. Bearer securities are negotiable instruments, and as such their legal nature is fairly clear. These instruments are excluded from the discussion, as the truly difficult legal problem is the nature of registered securities. Thus, to reiterate, references to "securities" are, unless the context indicates otherwise, references to *registered* securities.

Within this narrower focus, a number of deeper preliminary observations are required. As securities are built upon personal rights, part of the characterisation of securities as property stems from the bundling of rights into an ostensibly single and composite patrimonial object.[32] Thus in lay and commercial terms, a security is considered a bundle of rights.

However, in legal terms, this is not entirely accurate. In the beginning of this section, it was put forward that securities are comprised rather of a bundle or complex of both personal rights (arising from contract, statute or otherwise) *and* other competencies (usually arising from statute). This idea was further developed to show that this results in an even larger number of potential functionalities, or incidents.

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31 As envisaged by Joubert (1958) *THRHR* 12 *et seq* & 98 *et seq*; but see also: L Du Plessis *An Introduction to Law* 3 ed (1999) 132-146; and JD van der Vyver "The doctrine of private-law rights" in SA Strauss (ed) *Huldigingsbundel vir WA Joubert* (1988) 201-246.

32 "Ostensibly" because it is uncertain whether these rights may be "unbundled" and ceded severally. However, this work enables a better understanding of limited real rights *in* securities, which it is submitted is the best way to solve this issue as it avoids the problem of separation altogether.

It would appear as though the characterisation of all securities, and not merely shares, as a "bundle of rights" is relatively uncontentious – see Van der Linde & Lutz (2009) *SA Merc LJ* 631 & n 1.

Examples of true (i.e. personal) rights include the right to receive a proportionate share of the declared dividend, or the right to receive repayment of a sum loaned. Competencies is the chosen terminology for what are often also referred to as "rights" (in the wider sense), or as "powers", "privileges", "capacities" or "entitlements". Examples of these competencies include the competency to vote at shareholders' meetings, the entitlement to demand certain information regarding the issuer, or the power under certain circumstances to demand that an issuer reacquire a security at a fair market price (i.e. the appraisal right found in s 164 of the Companies Act).

The rights and competencies that are "bundled" as securities have *economic or monetary value*. This is why securities are considered a specific type of financial *asset*.[33] In strict legal terms, to state that something is an asset is to state that it has patrimonial value.[34] Real, immaterial property and personal rights all have economic or monetary value, and as such constitute patrimony.[35]

However, personal rights are unique, as the legal object of the right – i.e. performance – only materialises *after* the right arises or is created. It is undoubtedly correct that "performance which is the object of a personal right, in fact, only comes into being once the debtor actually performs…[and] because the performance-as-legal-object only becomes a reality once the debtor performs, a personal right…is in fact a "*claim against* a specific debtor *to perform*".[36] It would appear to follow that personal rights are *present* claims to *future* performance, it being theoretically irrelevant whether the life-span of the claim (extinguished by performance itself)[37] lasts nanoseconds or years, or envisages once-off or repeated performance. Thus, crucially, the patrimony of a personal right is the value of the *claim* against the performance-debtor, not the value of the performance itself.

Naturally the value of a personal right will be determined primarily with reference to the true economic value of the performance which the claim envisages, but these two values are not necessarily the same. This can be illustrated by examining certain factors arising *between* the creation of the claim and the realisation of performance (but ignoring factors arising during and after the realisation of performance, circumstances which are well illustrated by the function of the e*xceptio non adimpleti contractus*). Examples include the likelihood of performance materialising, or the uncertain quality of the performance until it occurs. The effect of these factors on the value of the claim is typically a

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33 J Benjamin *Interests in Securities: A Proprietary Law Analysis of the International Securities Markets* (2000) 4 (§ 1.02) containing also an excellent overview of the etymology of the term securities.

34 See J Neethling, JM Potgieter & PJ Visser *Law of Delict* 4 ed (2002) 219-220; M Loubser & R Midgley (eds) *The Law of Delict in South Africa* (2010) 47; *Union Governement (Minister of Railways and Harbours) v Warneke* 1911 AD 657 665; or, for a comparative perspective, GL Gretton "Ownership and its objects" (2007) 71 *Rabels Zeitschrift für ausländisches und internationales Privatrecht Bd.* 802 832.

35 Du Plessis *Introduction* (1999) 145.

36 Du Plessis *Introduction* (1999) 144.

37 On the nature of which it is crucial to take note of the observations on the extinguishing of obligations found in JE du Plessis "Die regsaard van prestasie" (2002) 65(1) *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 59.

function of the performance-debtor. In other words, the characteristics (or the state) of the performance-debtor primarily determines the present patrimonial value of the claim (i.e. the right), functioning as a key predictive factor of the value of the performance to be tendered.

This facilitates certain observations regarding the rights inherent in securities.[38] Securities should be characterised as a bundle of *claims* and other competencies operative against the issuer, who (it is implied) is always one person. That person appears also always to be an artificial legal person, whether a juristic person such as a company, or a sovereign entity such as a state or municipality. Moreover, securities may contain a single right or multiple rights. Corresponding performances are similarly variable. Some instances of performance may be once-off, such as acceptance of a predetermined offer in a future securities subscription,[39] or payment of a monetary equivalent of a proportional share in the residual assets of a company.[40] It can also be recurring and ascertained (such as the fixed income coupon payments found in debt securities) or recurring and ascertainable (such as the dividend income of ordinary shares). However, despite this variability, it is common to all securities that the objects of their rights are predominantly realised on a *future* date or series of dates, so that the end economic benefits of performance are mainly realised during or at the end of the securities' operative lifetime, or a combination of both.

It follows from the above that over the lifetime of a security, its patrimonial value rests primarily on the value of the *claim* to any performances not yet realised. The point is that this, in turn, rests as much on the true economic value of the performance envisaged as it does on the characteristics or state of the performance-debtor. This is why it can be definitively stated that the *present* value of a security (i.e. the value of surviving claim or claims to performance together with, perhaps, a premium for its other competencies) is determined not only with regard to the stated value of the promised performance, but also as a function of the state of the issuer. For example, the state of a company-issuer will typically be determined by estimating its discounted future cash flow (or earnings before interest, depreciation, tax and amortisation), whilst the state of a sovereign issuer will typically be determined by its credit-rating in conjunction with certain forecasted macro-economic variables. These are, in fact, among the currently predominant metrics used to evaluate the worth of such bundles of claims, speaking to the likelihood and quality of future performances. For this reason it should follow, for example, that the credit rating given to a country's sovereign debt or a bank by a rating agency influences the *present market value* of the debt securities of that state or bank.

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38 See also Chapter 6, § 6 3 3.

39 As correlative performance to the right found in an option to subscribe to a future securities issue. There is some uncertainty whether an option to take up securities can be a registered security in the true sense. Here it is assumed that the answer is in the affirmative, but this issue requires further exploration.

40 As correlative performance to the so-called "capital rights" of shares.

With this in mind, what is meant by "ownership" and "moveable property" in relation to securities? The courts have made it clear that:[41]

> "'ownership' may, juristically, not be accurate in relation to the rights of the person in whom...shares vest."

Further, it has been noted that:[42]

> "[i]n some instances, however, the registered shareholder may hold the shares as the nominee, i.e. agent, of another, generally described as the 'owner' or 'beneficial owner' of the shares…The term 'beneficial owner' is, juristically speaking, not wholly accurate, but it is a convenient and well-used label to denote the person in whom, as between himself and the registered shareholder, the benefit of the bundle of rights constituting the share vests…Although the rights conferred by a debenture on a debenture-holder differ in content from those enjoyed by a shareholder, similar considerations apply to the registration of debenture-holders, the issue of debenture certificates and the holding of a debenture by a nominee."

There is also a long-standing and extensive comparative law debate, in Civilian and mixed-heritage systems, regarding the precise meaning of ownership more generally.[43] Moreover, the ostensible proprietary legal consequences (including the problem of ownership) of intangibles as things has its own history of contention.[44] These issues, originating primarily from logical inconsistencies in the Gaian arrangement of things inherited by the Civilian system, are outside the scope of this work. But it is also largely unnecessary to deal with them directly, and the final section of this chapter will do so only in so far as is necessary.

With regard to securities specifically, already nearly three and a half decades ago it was noted that:[45]

> "[t]he reason for this lack of suitable terminology and for the uncertainties encountered in transactions in intangibles is simple. The law proceeds from the tangible as the unit of wealth and object of legal transactions. This approach, rooted in history and tradition, is no longer valid and leads to uncertainty where the highest degree of certainty is required."

Ownership in the present context can only mean ownership *of* rights, rather than ownership *as* rights. Thus the term "ownership" must be treated as an analogy, originating from ordinary speech, because

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41 *Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd* 1976 (1) SA 441 (A) 447H - 453A.

42 *Standard Bank of SA Ltd v Ocean Commodities Inc* 1983 (1) SA 276 (A) 289.

43 See both AM Honoré "Ownership" in AG Guest (ed) *Oxford Essays in Jurisprudence* (1961) 107 and Gretton (2007) *RabelZ Bd.* 802 for invaluable discussions of these issues, covering a multitude of legal systems and a number of leading contentions.

44 See for instance D Kleyn "Dogmatiese problem rakende die rol van onstoflike sake in die sakereg" (1993) 26(1) *De Jure* 1; AJ Van der Walt "Die mandament van spolie en *quasi*-besit: *Bon Quelle (Edms) Bpk v Munisipaliteit van Otavi* 1989 (1) SA 508 (A)" (1989) 52 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 444; Van der Walt & Sutherland (2003) *SA Merc LJ* 95.

45 FR Malan *Collective Securities Depositories and the Transfer of Securities* (1984) 194.

"[i]n ordinary speech we say that we own physical objects, such as cars or buildings, and also that we own immaterial things, such as company shares or patents."[46]

Although it has been criticised,[47] it is in all likelihood more appropriate to use the term "holdership" when dealing with these relationships. GL Gretton, in particular, argues that:[48]

> "we do not ordinarily say that we 'own' a contract or a claim in delict. Even within the field of property law, we would not ordinarily say that we 'own' a lease or a security over land. For such rights verbs like 'have' or 'hold' seem more natural than 'own'…It seems to me that 'have' is a fundamental legal concept, meaning the *relation* of a *person* to a *right…*[although this] in some cases does violence to ordinary speech, which, as already mentioned, allows us in at least some types of case to speak of the 'ownership' of things which are rights rather than physical objects, such as company shares and patents."

Thus it is more useful, and more accurate, to speak of beneficial interest *holders*, as well as the rights-, security-, instrument- and asset-*holder*s, and attempt to do away with the term ownership altogether.[49] This is further expanded upon below in § 4 3 2 below.

Consider the following comments by the authors in *Commentary on the Companies Act of 2008* (hereafter "*Commentary 2008*"):[50]

> "*(d) Variable interpretation and use of 'holder'*
>
> While ordinarily a 'shareholder' and 'holder' is a person whose name is entered on the company's securities register with such person having registered title to the relevant securities, sometimes these terms are used or interpreted more loosely depending on the context. These terms may be used to refer to, or include, a person who is absolutely entitled, as against the company, to be registered in the securities register, or the 'holder' of a beneficial interest (including 'beneficial owner') of the relevant securities. For example, the term 'holder' was used in the repealed Securities Regulation Code on Take-overs and Mergers applicable under the 1973 Act, and in this context it was defined as meaning 'the direct or indirect holder of securities', and

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46 GL Gretton "Owning rights and things" (1997) 8 *Stellenbosch Law Review* 176 176. See also LCB Gower, JB Cronin, AJ Easson & B Wedderburn *Gower's Principles of Modern Company Law* 4 ed (1979) 400, as quoted below in § 4 3 2.

47 See for instance P Birks "The Roman concept *of dominium* and the idea of absolute ownership" (1985) *Acta Juridica* 1 26.

48 Gretton (1997) *Stell LR* 177.

49 As is done, for example, in the Companies Act when referring to a beneficial interest holder, or the holder of a share (see s 1 "shareholder" and "held" and "holder" in s 56). Unfortunately, to the contrary, the Rules of STRATE Ltd seem to use the term "legal owner" to refer to end-holder of the rights (Reg. no 1998/022242/06, last updated as per *Government Gazette* 40188 of 05-08-2016). The same problem is found in the Financial Markets Act 19 of 2012.

See also, for an alternative view, R Rachlitz "Disclosure of ownership in South African company law" (2013) 3 *Stellenbosch Law Review* 406.

50 Yeats et al *Commentary 2008* 2-586 – 2-587 & 2-588. See also a similar discussion of the meaning of "holder" in the context of rectification at 2-697 – 2-699 & 2-703.

> 'holding' was regarded as having a corresponding meaning. Based on this definition, and its use in relation to a change in control, it was interpreted by the Securities Regulation Panel (the predecessor to the Takeover Regulation Panel) as excluding the registered nominee shareholder and including only the 'controlling' holder. Nevertheless, in most instances the term 'holder' is interpreted restrictively as a reference to the registered holder only, which accords with the general definition of a 'shareholder' in s 1.
>
> …
>
> The preferred view is that the reference to the 'registered owner of the shares' should be read as simply the registered holder (i.e. the person with registered title), as registration is not synonymous with ownership and our courts have not expressly imported the English 'dual ownership' construct."

This also serves as another example of the less than adequate state of terminology in the field of securities law and the consequent confusion it gives rise to. It is respectfully submitted that, seen holistically, the benefits of the terminological framework proposed here outweigh the merits of the first position taken above, and so "holder" cannot – without the appropriate qualifier – be read narrowly. However, the clarification made in the final paragraph is eminently useful and supports the framework of usage outlined here, and it should be expanded also to prefer "beneficial interest *holders*" rather than "beneficial owners".

Regardless of terminological preference or accuracy, holdership of securities appears to bestow "moveable [incorporeal] property", which must be given a more precise meaning.

The law of things as a subdivision of private law[51] must be distinguished from *property law*. Property law extends beyond the law of things, and the term property itself accordingly goes further than things. It encompasses all forms of patrimony, irrespective of whether it is interpreted as the *right* to a legal object with economic or monetary value (in this case performance), the legal object itself, or even as the right *as object* of another right (such as when securities are pledged). It also extends beyond the boundaries of private law itself, having its own distinct public law and immaterial property law dimensions as well.[52]

Use of the term property in the context of securities is best understood with knowledge of its historical context. In Chapter 3, it was stated that the original determination in s 22(1) of the Companies Act

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51 These subdivisions of the positive law are often over-emphasised, but are more didactic constructs than problem-solving ones. That having been said, the distinctions themselves are not devoid of legal consequences. For example, public law human rights are, generally, not directly actionable in delict (see Loubser & Midgley *Delict* (31-34) as they are not capable of direct recognition within the underlying structure of the private law system. They are, instead, imported through pre-existing *open-ended* concepts that already exist within the latter system, the best example being their informing the delictual element of *wrongfulness.*

52 See PJ Badenhorst, JM Pienaar, H Mostert & M Van Rooyen *Silberberg & Schoeman's The Law of Property* 4 ed (2003) 1, § 1.1 & 19-21, § 2.2-3; CG Van der Merwe *Sakereg* (1979) 109; and also Du Plessis *Introduction* (1999) 138-145.

of 1926, as followed by all subsequent Companies Acts,[53] that shares are "moveable property" was a mere confirmation of the common law. It primarily ensured that shares, as interests in an association that holds immovable property, would not be classified themselves as immovables.[54]

However, the concept is slightly more useful than that. In light of all of the above, the "property" in question is clearly the patrimony inherent in the rights – i.e. the present (patrimonial) value of the *claim to the economic end-benefits* of outstanding performance. One cannot own this in the strictest sense, but the present value of the holder's claim certainly vests in the estate (or, in the case of a juristic person, among the assets) of the securities-holder, and in this way can, and should, be called property.

As will become clear, from this point forward, it will no longer be appropriate to use the term rights-holder. Instead, reference will be made to "*asset-holder*" and "*instrument-holder*" (of the two legal objects it is argued securities are comprised of), and if the term "*security-holder*" is used, it will denote a person who is both the asset- and instrument-holder of a particular security.

To understand the conception of a security as dichotomous, one must look deeper into the nature of personal rights. In the English law context of ownership of corporeal things, AM Honoré proposes an "account of the standard incidents of ownership, i.e. those legal rights, duties and other incidents which apply, in the ordinary case, to a person who has the greatest interest in a thing admitted by a mature legal system."[55] Terminologically, "incidents" appears to be a very useful word to describe various legal relationships that may arise between legal subjects and objects, and subjects and other subjects vis-à-vis an object, by virtue of ownership of a thing. Some of these "standard incidents" include: the right to possess, to use, to manage, the right to income and capital, to security, and also the incident of "residuarity". They are styled as the components, or content, of the legal construct of ownership, though they need not all simultaneously accrue to the person designated as owner by virtue of their existence.[56]

South Africa's view of ownership is more abstract due to its Civilian heritage. It recognises the various incidents that flow from ownership, but does not use these incidents to circumscribe ownership – rather it posits that ownership's full content is indeterminate and abstract.[57] Its *subjective rights* dimension has been said to comprise simply of the entitlements of determination

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53 See s 91 of Act 61 of 1973 and s 35(1) of the Act of 2008.

54 See MS Blackman, RD Jooste, GK Everingham, JL Yeats, FHI Cassim & R de la Harpe *Commentary on the Companies Act: Volume 1* (RD 8 2011) 5-168, and Yeats et al *Commentary 2008* 2-276 & n 10.

55 Honoré "Ownership" in *Oxford Essays* 107.

56 Honoré "Ownership" in *Oxford Essays* 112-113.

57 See *Chetty v Naidoo* 1974 (3) SA 13 (A), Van der Merwe *Sakereg* 111-112, and AJ van der Walt & GJ Pienaar *Introduction to the Law of Property* 6 ed (2009) 41-47.

(*beskikking*) and enjoyment (*genot*). Nonetheless, that these incidents exist is recognised, including that they may manifest in other (limited) real rights and bestowed upon legal subjects who are not the owners.

The question then becomes whether a similar view can be taken of personal rights – i.e. whether there are *severable* incidents of holdership of personal rights. One need look no further than the pledge construction of the cession *in securitatem debiti* to find an affirmative answer. Most South African authors agree, after initial criticism,[58] that the affirmation of *National Bank of South Africa Ltd v Cohen's Trustee*[59] in *Leyds v Noord-Westelike Koöperatiewe Landboumaatskappy Bpk*[60] entrenched the legitimacy of the pledge construction of a security cession. However, the theoretical nature of this pledge remains highly complex and still somewhat contentious.

Nonetheless this work boths supports and will for its purposes accept that the pledge-style security cession is:[61]

> "based on the idea of a limited cession to the cessionary of a particular component of the cedent's interest in the performance due from the debtor, namely 'the right to claim and receive…the amounts owing.'"

This is, of course, implicitly premised on recognition of the so-called components of the creditor's interest (*komponente van die skuldeisersbelang*) by the positive law.[62] Almost three decades ago Gerhard Lubbe remarked:[63]

> "*[d]aar is aanduidinge van 'n besef dat die siening van die vorderingsreg as bloot 'n invorderingsreg te eng is, en dat herbesinning oor die inhoud van hierdie wesenlike begrip van die privaatreg 'n uitweg uit die gewaande dogmatiese impasse rondom hierdie regsfiguur kan bied. Verskeie skrywers is van mening dat 'n vorderingsverpanding teoreties verklaar kan word deur 'n konstruksie wat verskillende aspekte of komponente van die skuldeisersbelang identifiseer en* erken dat hulle regtens van mekaar afgeskei kan word."

Viewing these indications with approval, Lubbe takes the position that a personal right is a composite construct. The components of this creditor's interest appear to be two-fold: (1) the *entitlement of enjoyment* as substantive interest – i.e. the patrimonial value of a claim to reap the economic end-

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58 S Scott *The Law of Cession* 1980 141 n 18, SWJ Van der Merwe, LF Van Huyssteen, MFB Reinecke & GF Lubbe *Contract: General Principles* 4 ed (2012)1 425-426, Lubbe "Cession" in *LAWSA,* § 180 & n 1.

59 1911 AD 235.

60 1985 (2) SA 769 (A).

61 Van der Merwe et al *Contract* 432 & n 379.

62 Lubbe (1989) *THRHR* 485.

63 GF Lubbe "Die verpanding van vorderingsregte en die regsdogmatiek – *quo vadis*?" (1991) 2 *Stellenbosch Law Review* 131 [own emphasis].

benefits of future performance in the interest-holder's estate, and (2) the *entitlement of determination* as the legal capacity, or power, to realise and enforce the claim to performance through action that enables the governing of the patrimonial interest.[64] However, attaching to, or perhaps more accurately flowing from, these two components of a personal right as claim are a multitude of incidents of holdership of a personal right, so that it:[65]

> "confers on the holder of the right not only the capacity and hence the *locus standi* to exact performance (to collect interest, in the case of a money debt, and capital once the claim has matured) but also a variety of other *functions*, such as the capacity to alienate, waive, novate or renew it, to cancel the transaction giving rise to it, to vote or claim a preference where the right carries such a privilege, to apply for the debtor's sequestration, to take advantage of a lien or suretyship, *and so forth*."

Much like ownership of things, the content of holdership of personal rights is not circumscribed by these incidents in South African law, but such incidents are indeed recognised. Understanding more precisely *how* they are recognised requires further refinement of the precise meaning of "incidents".

As far as circumscription is concerned, all subjective rights appear to be circumscribed by the entitlements of determination and enjoyment. However, it is clear that there are various incidents to which these two core entitlements give rise. From the preceding analysis, incidents are more accurately defined as functionalities which arise, or flow from, the *interaction* between: (1) holdership of entitlements, operating on the level of private law rights and relationships as between legal subjects, and (2) the systemic legal norms and rules on the level of the positive law to which they are subjected in legal interaction or interchange (*regsverkeer*).[66] Simply: holdership of these (two) entitlements bestows on the holder (many) *functionalities*, due to what the objective law allows the right-holder to do by virtue of her entitlements. These functionalities are the *incidents* of holdership, as they no doubt also are of corporeal ownership.

Whilst German law tends to view (with some academic dissent) a personal right as the sum of this bundle of incidents, this view is not preferred from a South African perspective.[67] First, it does unnecessary violence to one of the fundamental tenets of the doctrine of subjective rights, namely subjective rights as consisting of two core entitlements: determination and enjoyment. Second, the

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64 Lubbe (1991) *Stell LR* 144 n 85 – "*Myns insiens behels die* skuldeisersbelang in 'n vorderingsreg *twee afsonderlike komponente. Afgesien van die skuldeiser se substantiewe genotsbelang, dws sy belang in die verkryging van die skuldenaar se prestasie en die genot daarvan, geniet hy, in elk geval waar sprake is van 'n siviele verbintenis, ook die juridiese bevoegdheid om daardie belang deur middel van aksie te realiseer en andersins oor sy genotsbelang te beskik*." [own emphasis].

65 Lubbe "Cession" in *LAWSA* § 180 n 19 [own emphasis]. See also S Scott *The Law of Cession* 2 ed (1991) 240-242; Malan *Collective Securities Depositories* 210; NL Joubert *Die Regsbetrekkinge by Kredietfaktorering* (1986) 483-484; this also alluded to by Joubert (1958) *THRHR* 114-115.

66 See § 4 1 above.

67 See § 4 1 and with specific reference to Pahl *Die aanwending van vorderingsregte* 164-166 & 176; Lubbe (1989) *THRHR* 493-494 (also dealing with Pahl); and Lubbe "Cession" in *LAWSA*, § 180, n 19.

multitude of juristic acts which a legal subject may perform, and the legal consequences this brings about, due to mastery over a personal right, are *not* an indication of a multitude of different entitlements making up a personal right. Instead these are "mezzanine" manifestations of the dynamic interaction between private law rights and relationships, and the supra-operative objective law.

The legal dynamics of the pledge construction thus serve to confirm this view, doing so by doctrinal necessity. In order to achieve the policy-outcomes desired by a pledge of incorporeal moveable property, there is one core requirement. This is the handing over of effective control ("*heerskappy*") of the pledge object to the pledgee (the method of which varies depending on the nature of the pledge object). This is essential to the real agreement as foundation for a real right of pledge.[68]

Thus, the most compelling (and it is submitted most authoritative) view of how this is brought about is as follows. It first accepts that personal rights consist of two components: the entitlements of determination and enjoyment.[69] On this basis it posits that through taking a limited cession of the latter, the pledgee becomes the only person who can enforce and otherwise realise performance, gaining effective juridical control over the claim to the exclusion of the pledgor, whilst the "substantive right [i.e. *genotsbelang*] remains an asset in the estate of the cedent."[70] Why? The entitlement of determination confers on its holder the functionalities – i.e. incidents – associated with the *execution* of the claim to performance and its fruits. Thus the determination component of the right serves as the legal object of the limited real right that pledge bestows.

The entitlement of determination over the claim is handed over, because it confers *effective factual control* over its resultant incidents. Handing over control is the core requirement of the real agreement. In the absence of a possessory construct for personal rights, what is actually handed over to confer the necessary control is the ability to *execute* the right to the exclusion of others. That is the function of ceding the entitlement of determination. The importance of this cannot be overstated for what follows. While this doctrinal description is not without controversy, it would be difficult to conceive this type of security cession without it, and it is accepted here as correct.

Crucially, Lubbe also posits that the legitimacy of this view of the nature of personal rights is further supported by the structure of shares in company law. He argues that an explanation of the difference

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68 Lubbe (1989) *THRHR* 490-492, specifically establishing that this requirement of pledge in the general sense is not the handing over of possession, but rather establishing the pledgee's effective *control* of the pledge object. It is also convincingly argued that, in contrast to corporeal moveables, a second core requirement of publicity is not to be overly emphasised.

69 Lubbe (1989) *THRHR* 497. Usage in text is: *beskikkingsbevoegdheid* or *opvorderingsbevoegdheid* and *genotsbelang* or *genotsbevoegdheid*, respectively.

70 Van der Merwe et al *Contract* (2012) 432 & authorities cited in 382-383. See further Lubbe (1989) *THRHR* 490-492; Lubbe (1991) *Stell LR* 145; Lubbe "Cession" in *LAWSA* § 180;

between registered shareholdership and beneficial interest holdership as a splitting of the entitlements of determination and enjoyment (caused by the effect of the share register on the issuer's obligations) presents the most rational and doctrinally sound view of this aspect of shares.[71] This is undoubtedly very close to correct. With certain refinements, and applied to all securities equally, this idea forms the foundation of the security asset and instrument dichotomy posited here.

With this as the basis on which the asset-instrument dichotomy will be drawn, a further issue is whether such structural modifications to the *totality* of the underlying interest (as rights and competencies) can be irreversibly effected and made an inherent quality of that security.

In *Smuts v Booyens; Markplaas (Edms) Bpk v Booyens,*[72] Cameron JA confirmed that a company's memorandum, as a binding covenant between shareholders inter se,[73] should be viewed as an intrinsic property of the share itself.[74] On this basis the court was able to hold that a restriction on the right to transfer shares[75] is, where it is an aspect of that memorandum, therefore also part of the innate characteristics of the share.[76] Thus, *in casu* the applicable right of pre-emption, as a *structural feature of the share*, meant that an inherent quality of the share in question was such that it could not be transferred unless there was compliance with relevant provisions in the memorandum.[77] The use of the term "securities" in s 8(2)(b)(ii)(aa) of the Act of 2008 appears to have extended this structural feature to any security issued by a private company. The extent and application of this concept of *intrinsic* restriction, in contrast with an extrinsic contractual one, has also been expressed usefully as follows:[78]

> "[t]he courts refer to the latter intrinsic restrictions as being rights created non-transferable *ab initio* as an 'original incident' of the rights themselves. However, it is submitted that these need not literally be 'original' because the restraints can be agreed to by way of an amendment of the rights subsequent to their initial 'creation' and therefore in these notes they are simply referred to as 'intrinsic restrictions' (i.e. arising from the agreement circumscribing the right, as opposed to a superimposed restriction). It is submitted that,

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71 Lubbe (1989) *THRHR* 497-498. See also § 4 3 2 1 below.

72 2001 (4) SA 15 (A).

73 See also s 15(6) of the Companies Act of 2008 (enacted after the case was decided).

74 *Smuts v Booyens; Markplaas (Edms) Bpk v Booyens* 2001 (4) SA 15 (A) para [14], citing *Borland's Trustee v Steel Brothers & Co Ltd* [1901] Ch 279 288.

75 Compare this formulation to the 2008 Companies Act, which – in terms of s 8(2)(b)(ii)(aa) – requires that a memorandum of a private company "restricts the *transferability* of its securities" [own emphasis]. Of course, this seems not to alter the legal position in a material way, especially as the court interpreted the 1973 Act's provisions to mean that *transfer* in the global sense (*causa*, cession, and registered transfer) must be restricted – see *Smuts* paras [8]-[12].

76 Para [17].

77 Para [17] – "the right, from its inception, lacks the attribute of transmissibility", as quoted from *LAWSA's* volume on cession referenced throughout this section.

78 Yeats et al *Commentary 2008* 2-875.

generally, a restriction will be regarded as intrinsic to a right if it is created in the contract that gives rise to the right itself, for example, a prohibition against the cession of the rights of a party under an agreement which is included in the agreement itself with the purpose of limiting the right. In contrast, generally a restriction agreed to between a person holding the right and a third party cannot be regarded as intrinsic to the right because the right itself is not affected by such an agreement, which usually amounts to a separate contractual undertaking. The latter contractual restriction of a pre-existing right that does not affect the right itself is referred to as an 'extrinsic restriction' to distinguish it from an 'intrinsic restriction'."

The broader point, however, is that the concept appears to illustrate that *structural* restrictions may be built into the totality of a security's underlying interest - i.e. restrictions that serve to alter the structure of the underlying interest. The judgment seems further to imply that any party into whose hands an interest in such a security falls – i.e. the primary market acquirer *and* any successors – is automatically beholden to these structural features.

How? It is uncontentious to assert that a company's memorandum forms an inexorable part of the overall constitutive arrangement that gives rise to a share. This is further underscored in *Cooper Boyes NO,*[79] in citing with approval the seminal English dictum of *Borland's Trustee v Steel Brothers & Co Ltd*:[80]

"A share is the interest of a shareholder in the company measured by a sum of money, for the purpose of liability in the first place, and of interest in the second, but *also consisting of a series of mutual covenants* entered into by all the shareholders *inter se*…"

The core of the ratio in *Smuts*, also illustrated above, is that aspects of the relationship between shareholders inter se, as well as between shareholders and the company, can be made intrinsic to the share itself. Another area where this principle is evident is the treatment of "convertible securities" in terms of the Companies Act, where:[81]

"because the definition of 'convertible' only applies to the terms of a security, the option must be *part of the security* (not just an ordinary option) to qualify…Therefore one has to determine whether the security in question has the requisite voting rights or contains an option to acquire, or a right of conversion into, securities having the requisite voting rights in relation to the particular matter at the particular time. The starting point of such an enquiry would clearly be a company's memorandum of incorporation."

In the context of contractual securities (of companies or otherwise), the exact same reasoning applies, albeit for different reasons. Here a *contractual* constitutive arrangement creates the underlying interest, similarly to the manner in which a memorandum of incorporation, in conjunction

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79 1994 (4) SA 521 (C) 533.

80 [1901] 1 Ch 279 288.

81 Yeats et al *Commentary 2008* Int-122.

with the act of issue of shares by the directors, creates the underlying interest of a share. The terms and conditions of such a contract are incorporated, by reference, into the underlying interest of the security itself.[82] Thus, by an extension of the reasoning in *Smuts*, the structural features imposed by the acquiring contract are embedded into the security itself. This is also confirmed in common law when a *pactum de non cedendo* is construed as imposing an *intrinsic* restriction rather than one separate from the original source of the obligation,[83] as well as in analysing whether options are intrinsic or extrinsic to debt securities whose constitutive arrangement does not include the company memorandum.[84] In sum, whether by means of a memorandum, an acquiring contract, or some combination thereof, the totality of the constitutive arrangement giving rise to a security may clearly, as per *Smuts*, "build in" certain restrictions and, crucially, other potential modifications to the underlying structure of the *rights themselves*.

It must further be asked why this dichotomous construction of securities is necessary in the first place. South African company law is largely based on English law, and it appears to have been the principal source of best practice in many matters of law relating to securities at large.[85] This is illustrated by the fact that debt securities emulate, contractually, the arrangements regarding exclusive performance towards the registered holder (which originated in company law regarding shares).[86] However, any reception of English law principles must reckon with the mixed legal heritage of the domestic dispensation, none more so than those elements of private law that reflect its Civilian lineage.

English law allows a distinction between beneficial (or equitable) ownership and legal ownership, and correspondingly reads a constructive trust into the relationship between registered holder and beneficial owner. Neither dual forms of ownership nor a constructive trust is recognised in South African law.[87] Nonetheless the distinction between registered title and ownership of, at least, shares

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82 See § 4 2 below.

83 Yeats et al *Commentary 2008* 2-874 – 2-875 & numerous authorities in n 489 therein.

84 Again, regarding the definition of "convertible" in the Companies Act, see Yeats et al *Commentary 2008* Int-122 – Int-123:

> "traditionally the terms of a debenture are sometimes set out in the debenture certificate or debenture trust deed and the terms of an option constituting a non-share security could be recorded in a written agreement. While there would ordinarily be an argument that one is restricted to the intrinsic rights reflected in the memorandum of incorporation, the definition of 'convertible' makes it clear that options to acquire securities are to be taken into consideration. Where the option is part of the terms of a debt instrument, it is often not recorded in the memorandum of incorporation. As stated above, there is a possible argument that the introduction to the definition of 'convertible' should be interpreted as confining the enquiry to only those options provided for in the terms of the relevant security, which would exclude a separate, self-standing option agreement that is not itself a security and does not form part of the terms of any security."

85 See Chapter 3, § 3 1.

86 See § 4 2 below.

87 *Lucas' Trustee v Ismail and Amod* 1905 TS 239 247-248; *Princess Estate and Gold Mining Co Ltd v Registrar of Mining Titles* 1911 TPD 1066 1078.

has long been recognised.[88] The rights underlying securities are traditionally viewed as vesting only in the person who holds the so-called beneficial interest.[89] In this way:[90]

> "[b]y approximating registered title and ownership to legal and equitable title respectively, the concept of the share as found in English law is at least superficially integrated into the South African legal fabric."

The doctrinal incongruity of this "superficial" reception has caused a number of persistent problems. The first is the nature of the relationship between registered and beneficial holders. As a point of departure, the nominee-beneficial owner relationship has at least been confirmed as one of representative agency and not trust (even in term of the less strict or formal domestic meaning as a mere fiduciary relationship).[91]

However, theoretical problems persist. For instance, this does not clarify issues such as whether in terms of a forml, or true, trust the trustee or beneficiary of a trust is beneficial owner of the shares, or on what basis the ostensible owner of a share can vindicate her proprietary interest.[92] The current Companies Act further exacerbates these problems through its own problematic treatment of the beneficial interest. More pervasively, it causes the law to ascribe two different legal positions to legal problems regarding securities and the use of a nominee – the position in terms of internal relations between holders and issuer, and that of external relations (i.e. of third parties).[93]

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88 See for instance *Farrar's Estate v CIR* 1926 TPD 501; *Jeffery v Pollak and Freemantle* 1938 AD 1 18; *West v De Villiers* 1938 CPD 96 102; *Moosa v Lalloo* 1956 (2) SA 237 (D); *Verrin Trust and Finance Corp (Pty) Ltd v Zeeland House (Pty) Ltd* 1973 (4) SA 1 (C); *Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd* 1976 (1) SA 441 (A); *Standard Bank of South Africa Ltd v Ocean Commodities Inc* 1983 (1) SA 276 (A).

89 Blackman et al *Commentary* 5-169 n 3, 5-170 & 5-172, and A Borrowdale "The transfer of proprietary rights in shares: a South African distillation out of English roots" (1985) 18(1) *Comparative and International Law Journal of Southern Africa* 36. This is discussed in the context of shares, but there is no reason why is cannot apply equally to contractual securities where the issuer is also bound only to perform to towards the registered holder.

90 Borrowdale (1985) *CILSA* 40. See also Yeats et al *Commentary 2008* 2-802 – 2-803 (together with a number of useful examples at 2-809 – 2-810):

> "It is much harder to explain under South African law how the ownership of the rights (which can be vested in a beneficial owner without registered title) can be separated from the corresponding obligations. A full theoretical engagement with this issue is beyond the scope of these notes, save to say that, influenced by the English law, our courts appear to have to at times reached functionally comparable conclusions…"

91 See also Chapter 3, with additional analysis in § 4 3 1 below.

92 See Borrowdale (1985) *CILSA* 41-43 (discussing specifically *Randfontein Estates Ltd v The Master* 1909 TS 987) and 43-46 (discussing *Verrin Trust and Finance Corp (Pty) Ltd v Zeeland House (Pty) Ltd* 1973 (4) SA 1 (C) and *Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd* 1976 (1) SA 441 (A) in relation to one another), respectively.

93 This notion is further elaborated upon below, in § 4 1 3 as well as in § 4 2.

See also *Verrin Trust and Finance Corp (Pty) Ltd v Zeeland House (Pty) Ltd* 1973 (4) SA 1 (C) at 13D-E:

> "title to be on the register and title to the disputed shares are distinct issues and a Court confronted with an application [for rectification] is entitled to confine itself to the former issue and leave the latter, and other related issues, to be debated in a separate trial action."

Further, see *Jeffery v Pollack and Freemantle* 1938 AD 1 18-19; *Davis v Buffelsfontein Gold Mining Co* 1967 (4) SA 631 (D) 633D; and *Boorman v Steynberg NO & Another* 2001 (2) SA 116 (C) 123G.

Thus an understanding of the difference between registered holdership and beneficial interest holdership in respect of securities that resolves this legal friction is necessary. Most importantly it must accord with the typically Civilian manner in which South African law views property and obligations, but which also gives consistent and robust effect to the legislative matrix operative in this area of the law, which is strongly influenced by, if not outrightly derivative of, Anglo-American law.

4 1 2 Patrimony of securities: the security asset

From this point forward, the analysis will begin to focus specifically on securities *as the result* of structural features evident in the positive law. In so doing, there will be less emphasis on the subjective rights-dimension found *within securities* (as this paradigm in any event begins to lose its explanatory and problem-solving value), in favour of the underlying structure *of securities*, focusing on securities' incidents.

It is clear from the above that the law countenances characterising personal rights (and by analogy other competencies) as comprised of two foundational (and severable) entitlements. Their interaction with the objective law, driven by the exercise of legal subjectivity, allows one further to ascribe various legal incidents to these claims. Further, it shows that there is a precedent for detachment of the incidents of execution from the other incidents of a claim to performance in the pledge *in securitatem debiti*.

The notion of the security asset and the security instrument is a further development of this concept. The latter is an "instrument" to which accrues all incidents of execution, and what is left of the securities' underlying interest is the security asset, bestowing the remaining incidents which correspond to the patrimony inherent to those rights. This section and the next serve to more precisely describe the security asset and instrument, as well as some of the more technical aspects of holdership.

Upon issue, securities come into existence. Depending on the security this could be the moment when all rights and competencies underlying that security come into effect. Alternatively, as will be seen in the second section of this chapter, it could be *dies venit* (or even *cedit* and *venit*) for certain existing rights and the coming into existence of others together with the competencies associated with the particular security.[94]

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[94] See § 4 2 below.

However, despite their numerous differences, it is submitted that all securities come into being allowing for the ability to "execute" the underlying interest to be held by someone other than the beneficial holder. Shares do so inherently, by virtue of arrangements made by company law.[95] Contractual securities arrange this state of affairs primarily in their acquiring agreements, either alone (sovereign debt securities are a good example, and this principle holds even if the securities in question are non-transferable),[96] or in conjunction with statute (such as the Companies Act's securities register in the issue of s 43 debt securities). Lastly, interests in a collective investment scheme (ICISs) are variable in nature and will typically achieve this in the manner most appropriate to the vehicle of the scheme (such as an open-ended investment company, where shares are used).

It would be difficult (though, as per Chapter 6, not impossible) even to *classify* a particular legal interest as a traditional South African security if it did not arrange that the holder of the entitlement of determination (on the one hand) and patrimony (on the other) of that interest could be different persons.[97] This is one of the definitive characteristic of securities, and is the result of the impact of very specific historical-economic developments[98] on the domestic law.[99] The underlying policy considerations that shape this state of affairs are also clear: severing *registered* ownership from *beneficial* ownership is economically efficient. It lowers the transaction costs of holding, trading, encumbering, performing in terms of, and even creating securities, and allows intermediary actors (such as brokers or underwriters) and platforms (such as exchanges) to intercede on a collective scale.

Therefore, it is submitted that securities come into existence as two interdependent legal constructs. The first is the security instrument, which consists of the incidents of *execution* of the security – the result of an *ab initio* allocation to the instrument of something corresponding to a global entitlement of determination (*beskikkingsbevoegdheid*) over the totality of the underlying rights. Second is the security asset, to which is allocated a global entitlement of enjoyment (*genotsbevoegdheid*), consisting of all incidents which remain after the incidents of execution have been shorn from the underlying interest. The asset can thus be characterised as patrimony in the estate of the asset-holder. Of absolute importance is that, as will be elaborated upon in § 4 3 2, these two constructs are *separate legal objects*, subject to different forms of holdership by different persons. However,

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95 The interpretive problems of the Companies Act, specifically s 56, are dealt with in this work as they arise, but merit further, free-standing analysis.

96 See below at § 4 2.

97 See Chapter 6, § 6 3.

This point is further strengthened by the law's treatment of money market instruments, which if issued to bearer without the use of the securities market's custody and administration architecture are terminologically distinguished from money market *securities*, being those instruments which do utilise this infrastructure, and thus exhibit the properties of registered securities - see Chapter 1, and Chapter 3, § 3 2 2 2.

98 See Chapter 2.

99 See Chapter 3.

these two constructs nonetheless flow from the same underlying set of rights and competencies, with both containing a component of *each* security's subsidiary rights and other competencies, so that they cannot be described as fully separate, but rather as *separate but interdependent*.

What the previous section did not address is how the proposed incidents-analysis is of application to competencies not easily classifiable as rights. These competencies arise *ex lege*, and typically by operation of statute. They are products of the objective law. The previous section, which outlined various such incidents, included the so-called right "to vote or claim a preference where the right carries such a privilege".[100] This is undoubtedly a reference to shares, and since the passage of the Companies Act of 2008 it can now also refer to company debt securities with voting "rights". Further, if debt securities are issued through a trust, these securities could also confer a comparable competency to vote at trust beneficiary meetings.

To describe these and other competencies as incidents of *rights*, however, is not correct. Instead, it must be understood that these competencies accrue to the *security as a whole.* In *Ben-Tovim v Ben-Tovim* the court stated that "the right to vote is attached to the share itself *as an incident of property* which may be exercised by the shareholder in his or her own interest."[101] Whilst the thrust of the point is correct, it is perhaps better served using a term other than incident in this context. Voting as well as all other competencies do not serve as the incidents of right-holdership, but as incidents of *security*-holdership, forming part of a bundle of rights and other competencies. These competencies reside alongside the security's rights, rather than flowing from them. If the underlying personal rights do not or should not have come into existence, the security cannot come into existence, and thus neither can the competencies. Yet the opposite is also true – rights and competencies are linked, and the fact that both require the coming into existence of the security shows that each accrues separately to the security as a whole.

Ultimately, the precise nature of these competencies need not be exhaustively examined. It is sufficient to state that, typically through statute, the objective law simply causes them to come into existence upon issue of a security.[102] AJ van der Walt posits "subjective relationships" as an "expansion" of the doctrine of subjective rights, specifically in order to explain (*inter alia*) some of the possessory problems related to the mandament van spolie.[103] Such a view is equally helpful in explaining similar law of things related issues surrounding securities. The nature of these competencies seems very similar to these subjective relationships, defined as "[the] relationship

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100 Lubbe "Cession" in *LAWSA* § 180 n 18.

101 2001 (3) SA 1074 (C) 1088. Put differently, these competencies accrue to the bundle as a whole, but thus also arise as *part of* that bundle.

102 This may include statutes which arrange for such competencies to arise (e.g. company legislation), the constitutive document or arrangement of the issuer, or perhaps even the common law.

103 Van der Walt (1990) *THRHR* 316, specifically 325-329.

between one or more legal subjects and one or more legal objects which has legal effects and implications",[104] but which are not subjective rights. By virtue of the nature of personal rights, security-holdership creates a set of relationships between the holder and the security, and by implication the holder and the issuer. The competencies in question exist as part this set of relationships.

The point need not be pursued to precision here, as the following is clear. First, these competencies can accurately be described as elements of security-holdership. Second, their underlying structure is, by virtue of securities' obligation-oriented content, very similar to personal rights, but they are not rights in that sense. Third, true personal rights and these competencies are analogous in one specific and crucial respect. The holdership of each of these competencies, just as with rights, entails a component of determination and component of enjoyment, exercisable against the issuer and protectable *erga omnes*.

The ability to *exercise* the competency is not the same as the ability to *determine how* it is to be exercised. It is fairly uncontentious, for instance, to state as a point of departure[105] that a registered shareholder who is not also the beneficial interest holder of a security is the only person who will be recognised by the company, with reference to a specific share, as a voter.[106] However, that holder cannot autonomously exercise a voting right at a shareholders' meeting without *authorisation and instruction* from the beneficial holder; she must similarly exercise any remedial competencies arising from security-holdership against the issuer in accordance with the beneficial holder's instructions and wishes. As a result, the ability to perform the juristic act of exacting compliance from the issuer (as counter-party), and the ability to perform the juristic act of deciding how it is to be exercised, are separate *entitlements* flowing from holdership of the competency. Therefore, each will yield different functionalities characterisable as separate *incidents*.

Thus, despite being creations of the objective law, their nature results in essentially *subjective* relationships (most obviously between issuer and security-holder), and so there must certainly be something analogous to entitlements of determination and enjoyment (*beskikkings-* and *genotsbevoegdheid*) in being the holder of such a competency. This explains why the capacity to exercise a competency can be severed, *as a separate entitlement of the competency*, from the power to decide how that competency is exercised. The former is clearly a power of determination over the

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104 Van der Walt (1990) *THRHR* 316 326.

105 It must be noted Part F of Chapter 2 of the Companies Act does contain a number of contingent divergences, or exceptions, from this principle, but it is submitted that the point remains viable as stated – a point of departure.

106 Blackman et al *Commentary* 5-169 n 3; *Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd* 1976 (1) SA 441 (A) 453; *Standard Bank of South Africa Ltd v Ocean Commodities Inc.* 1983 (1) SA 276 (A) 289; and, especially in terms of the interpretive difficulties of the Companies Act of 2008, specifically in terms of s 56, Rachlitz (2013) *Stell LR* 408-411.

Debt securities that have voting rights in terms of s 43(3) will be subject to the same considerations.

competency (the ability to demand compliance by the counter-party in its exercise), and the latter a power of enjoyment over the manner of its exercise.

Perhaps more so than any other feature of securities, these competencies as *part* of the underlying interest (and the treatment of that interest as a holistic whole) show that the security must be analysed in terms of holdership of its various incident-functionalities.

In summary, once issued, securities comprise a complex of underlying rights and other competencies. Each of these can be further subdivided into its two constituent entitlements from which, in conjunction with the positive law, flow various incidents. A security is the totality of incidents of *all* those rights and competencies. In a sense, all incidents of execution of a security represent the formal, supporting, or perhaps even in a certain sense "adjectival",[107] dimension of the legal relationships created by security-holdership. The remaining incidents of the underlying rights and competencies appear to represent the more substantive, patrimonial dimension of these relationships.

The crux of this and the next section is that these qualities present in a specific, determinable *structure.* Without the English common law concepts of legal ownership, equitable ownership and constructive trust, South African law *must* make use of the "bundle" or "complex" construction. In fact, the bundle construct serves as the critical midwife between irreconcilable Civilian and English common law principles in this area of law. When the rights and other competencies of a security are viewed as a bundle (i.e. as a *security* comprised of all the incidents of its various underlying rights and competencies) the law can be applied to its commonalities. Specifically, it is able to effect the holistic severance and re-allocation of certain incidents common to each of the subsidiary rights or competencies within the bundle, to the asset and instrument respectively.

This is what allows one to argue that the structure of a security is dichotomous: the collective incidents of *execution* of the content of the *bundle* accrue to the security instrument, and what remains is the security asset. The instrument and the asset can be held by the same person, or by different persons ("ownership of shares in South African law is completely distinct from, although frequently co-extensive with, the registered title to shares", and this applies equally to other registered securities).[108] Yet these two components come into existence as two distinctly separate,

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[107] This may not be the correct term, strictly speaking. It is meant to convey that certain incidents of rights and competencies have a more "procedural" than "substantive" feel – the best example being that the incident of having the requisite "*locus standi* to exact performance", as quoted above (Lubbe "Cession" *LAWSA*, § 180, n 19).

[108] Borrowdale (1985) *CILSA* 37.

yet interdependent,[109] elements of security-holdership *ab initio*. Indeed they must be regarded as separate legal *objects* if they are to fulfil a function of doctrinal harmonisation.

The instrument will be further discussed in the following section. The nature of the asset must now be more fully described. It is clear that the security asset and its holder are a refinement and extension of the traditional notion of beneficial ownership and corresponding beneficial owner.[110] The security instrument, in turn, is an extension and conceptual refinement of the notion of registered "rights" and the corresponding registered, or legal, "owner".

It is critical to clarify that though the asset and instrument are separate legal objects, they remain dichotomous parts of one whole – the security. They are not separate and severable proprietary interests linked by mere agency, they are different parts of the *same* proprietary interest (the security), *which in turn gives rise to that agency* due to its particular proprietary structure. So there is not fully separate ownership of each object, nor is there dual ownership of one security – it is *interdependent holdership of the incidents of the two core entitlements of the interests of which the security is comprised.*

As the substantive dimension of security-holdership, the security-asset is the component which confers patrimony. Severance of the incidents of execution from the underlying interest does not diminish the present patrimonial value of the underlying claims to future performance. It simply removes proximate *access* to that value. This is as true for the simpler pledge construction of the cession *in securitatem debiti* as it is for the analogous, but far more complex, security asset-instrument dichotomy.

Foundational to the patrimonial dimension of rights is the incident, analogous to Honoré's residuarity, also known as the "reversionary interest".[111] Even Roman (and Roman-Dutch law):[112]

> "recognised that *dominium* ('the ultimate right, that which has no right behind it') could be reduced to mere bare ownership or *nuda proprietas*, i.e. 'ownership stripped of its most valuable incidents'. South African [company] law has followed these precedents in allowing a severance of ownership and benefit, but this has not been to introduce the concepts of legal and equitable title which find no place in South African law."

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109 As each contains subsidiary elements of the *same* underlying rights and competencies, neither can exist without the other.

110 The wider definition of beneficial interest holder posited in contrast to "beneficial ownership" in Rachlitz (2013) *Stell LR* 412 is a response to the specific provisions of "beneficial interest" in s 1 as read with s 56 of the Companies Act of 2008, and whilst a fuller critique of the section and its formulation is required, this does not alter the proposed point of departure arrived at above regarding the nature of securities .

111 See § 4 1 1 above.

112 Borrowdale (1985) *CILSA* 36, citing therein (n 2 & 3): WW Buckland *A Text-Book of Roman Law from Augustus to Justinian* 3 ed (1963) 188 and RW Lee *An Introduction to Roman-Dutch Law* 5 ed (1953) 122.

Whilst clearly neither *dominium* nor ownership are appropriate to personal rights, this is an equally accurate description of the core functionality of reversionary interest (or bare beneficial interest) of personal rights. This is simply the present value of the content of the claim or claims (to the economic end benefits of all unrealised future performances) as *patrimony* in the estate (or, in the case of juristic persons, the totality of assets) of the asset-holder. In other words, it is the bare substantive essence of, or ultimate interest in, the future economic benefits of claims against a performance-debtor.

However, there are many other incidents which have little to do with execution. Thus, lacking the incidents of execution, the remainder must include at least the various incidents of alienation (a personal right-based *ius disponendi*). It also must include the incident of encumbrance, as it is trite that a beneficial interest holder is entitled to cede a security *in securitatem debiti*. Further, it must also include incidents such as *usus* and *usufructus* – it has been established that security-holders may grant *usus*, or a *usufruct* or *quasi-usufruct* over such securities in favour of third parties.[113] By virtue of *Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd*[114] a further possible incident may be something analogous to the *ius vindicandi.*[115]

Ultimately, this list is not intended as exhaustive, but rather illustrative. These incidents should not be seen as finite and determinate, because (as noted in § 4 1 1 above) the exercise of legal subjectivity which gives rise to these incidents is itself fundamentally dynamic. Lastly, the security asset also contains the power to *decide*, including to cause, on the exercise of all competencies that arise as part of the underlying interest of an issued security. This power, however, is also in principle shorn of its proximate capacity to *actually exercise* the competency, as this accrues to the security instrument as part of the incidents of execution.

Here it becomes important to note that whilst the incidents of execution do imply a measure of direct control over a security, it should be clear that control over the elements of patrimony of the security

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113 See *Cooper v Boyes* 1994 (4) SA 521 (C).

Crucially, if the security is a share or a perpetuity, the *usufruct* proper would be the correct construction, but if the security is a debt security – and thus consumable – the *quasi-usufruct* would be more appropriate (through which *ownership* is passed to the quasi-usufructary along with an obligation to return upon termination of the *usufruct* something of equivalent value – see also *Cooper* as well as § 4 3 2 and § 4 3 2 1 below for more on this issue).

114 1976 (1) SA 441 (A) 447H.

115 See also Borrowdale (1985) *CILSA* 43-46, evaluating *Oakland* as well as *Verrin Trust and Finance Corp (Pty) Ltd v Zeeland House (Pty) Ltd* 1973 (4) SA 1 (C); and Blackman et al *Commentary* § 5-172-173 in n 8.

For the possible application of a spoliation order based on *quasi*-possession see also *Tigon Ltd v Bestyet Investments (Pty) Ltd* 2001 (4) SA 634 (N). The court's rationale, based on *quasi*-possesion, has been justifiably and soundly criticised in Van der Walt & Sutherland (2003) *SA Merc LJ* 95, but in these authors own words at 101 – "the removal of the name of a member from the register of members is analogous to depriving a person of possession of a thing", and whilst the mandament van spolie is in all likelihood not applicable, there is the option of rectification, as "the remedy of rectification is analogous to the mandament…". This is dealt with in Chapter 11 of this work.

still reside with the *asset*-holder.[116] Thus incidents that result in proximate control over the *realisation and enforcement* of the content of the rights and competencies of a security, as bestowed by the security instrument, can be distinguished from incidents such as *usus* or the *ius disponendi*, which remain functionalities exercisable due to holdership of the security asset. To use specific examples: only the instrument-holder has access to the process of compelling the issuer to discharge its obligations in an adjudicatory forum (she has control over what might be called the incident of formal adjudicatory enforcement); alternatively, only the asset-holder may give a right to the fruits of a security to a third party (she has control over the incident of *fructus*).

In this way the security asset can be described as conferring, through holdership, all the incidents of holdership of the security flowing from its underlying interest, except those that confer formal, supporting, or adjectival, elements of the realisation of that interest. This is both the nature and positive law basis for postulating the existence and nature of the security asset.

The final building block is the interrelation between separate asset- and instrument-holders of the same security – a secondary *interceding* relationship of representative agency which arises between separate (asset- and instrument-) holders of the same security. It confers upon the asset-holder as principal the power to *direct* the instrument-holder (i.e. agent) upon matters related to the exercise the incidents of execution of the security, although the incidents themselves (and thus proximate control over the realisation of the content of the rights and competencies) remain solely within the capacity of the agent.[117] This agency construction is revisited in the final section of this chapter.

This analysis has largely ignored important differences in the nature of the security asset arising where a certificated security is exchanged for an uncertificated security instrument or where a security has been issued in uncertificated form, and also contains itself to discussing operative dynamics of *individual* securities. The few, but necessary, deviations from the foundational theoretical outcomes of this chapter in the context of uncertificated securities are dealt with fully in the following chapter and do not require material qualification here in this regard.

What remains is to lay out an argument for the nature of the security instrument. It must also be shown that these dichotomous components of securities are not created during the lifetime of a security (as is the case with a real agreement that serves to split the incidents of rights for the pledge construction of the security cession). Instead, it is submitted that the dual structure of the holistic complex of rights and other competencies arises *ab initio* from the moment the security is issued, even if the holders of both are the same person. An explanation of the security instrument is more

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116 See Lubbe (1989) *THRHR* 493-494.

117 See § 4 3 1 below.

difficult and contentious, as it represents a more radical departure from securities jurisprudence as currently viewed.

4 1 3 Execution of the underlying interest: the security instrument

Much of the exposition necessary to properly describe the security instrument has been done above. Yet, more is required before the aim of this section, which is to put forward a cogent argument that the security instrument is an existing abstract feature of the positive law, can be achieved. Here some preliminary distinctions will begin to be drawn between certificated and uncertificated securities, but uncertificated securities are primarily dealt with in the following chapter so that the discussion here focuses on understanding and outlining first principles only.

Again, framing what is currently thought of as the registered rights of a security as a security instrument does not represent a re-invention of the theoretical wheel. Instead, it is an attempt to re-conceptualise the notion of registered rights in a way that: more accurately and robustly reflects that state of the law; has explanatory and problem-solving value; and which harmonises the doctrinal underpinnings of South Africa's mixed legal system with the rules interposed by legislative interventions and other recent legal developments regarding securities.

The current position is not satisfactory, and is best articulated (at technically necessary length) as follows:[118]

> "*Traditionally, registered title has been regarded as comparable to 'quasi-possession' and distinct from the beneficial vesting of the rights comprising a share*, referred to in these notes as 'beneficial ownership'…As a consequence of the aforegoing, registration as a shareholder has been regarded as distinct from beneficial ownership for a long time. Under the 1973 Act, to become a registered shareholder (a member) of a company a person had to either be a subscriber to the memorandum of association of the company at incorporation or subsequently agree to become a shareholder (member) and be recorded in the register of shareholders (members). Consequently, a company was generally required to look only to the persons recorded in its register of shareholders (members) and to effectively regard them as the holders of all the rights and obligations associated with the relevant shares. Where there is a separation of registered title from beneficial ownership, under English law the registered holder is regarded as vested with the rights as legal owner in terms of the common law but holding the rights as trustee for the benefit of the relevant beneficial owner. In contrast, under South African law the registered holder is regarded as a *sui generis* agent *'holding' the rights for the benefit of the beneficial owner.*

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[118] Yeats et al *Commentary 2008* 2-669 – 2-670 [own emphasis]. At 2-688 the authors also state that "registered title is a *proprietary right* distinct from beneficial ownership" [own emphasis].

> Despite the agency construction applicable to nominees, a person recorded in the register, generally, could not be deprived of such registration without the person's consent or a court order. *Hence, registered title was regarded as a right in itself, somewhat akin to possession of a corporeal* and the general principle was that the register of shareholders (members) should not be changed unilaterally by the company or any other person, at least where doing so would be contentious."

Further:[119]

> "Even though, under the 1973 Act, our courts stated that a nominee is not a trustee (as is the case under English law), but rather a *sui generis* agent, the courts continued to recognise registered title as a distinct proprietary (or at least quasi- proprietary) right in and of itself. For example, the registered title holder was entitled to bring actions in his own name and was not required to institute proceedings in the name of the beneficial owner when enforcing the rights attaching to the shares; to the contrary, the beneficial owner generally has to enforce the rights attaching to the shares as against the company through the registered title holder. From this, at least certain rights were regarded as vested in the registered holder as proprietary rights and hence registration was recognised as a form of title.
>
> …Accordingly, the holder of a security continues to have a form of registered title which should continue to be recognised as a self-standing proprietary right (this right has been regarded as a form of quasi-possession)…"

Though this conceptualisation must be credited for its valiant effort to reconcile the inherent doctrinal inconsistencies of the South African adoption of a fundamentally incompatible English construct, it cannot be accepted. The notion of registered title as both a right and a form of possession is a technically contradictory one, and also does not adequately explain the operative dynamics of the instrument – this will become increasingly clear below, in § 4 3. Furthermore, as discussed in more detail in the following chapter, it makes it more difficult to come to a satisfactory conclusion on the exact manner in which uncertificated securities function.

As is hoped to be shown, the re-conceptualisation proposed in this work is able to provide an explanation which does away with such doctrinal disharmony and legislative uncertainty. It rests on the following premises: (1) in this context "title" is not an appropriate legal designation in South African law; (2) "ownership" of rights (whilst more appropriate than title) should be framed as *holdership* of rights; (3) under South African law, in contradistinction to English law, there cannot be separate but simultaneous holdership of the same legal object; (4) holdership of an intangible object is being party to a bi- or multilateral relationship; and (5) the underlying interest of any given security bestows a multitude of subsidiary incidents, which are severable as individual sets of relationships. The conclusion to be drawn from these premises, without having to substantially rewrite, or reverse,

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119 Yeats et al *Commentary 2008* 2-692, with 2-737 – 2-738 & 2-739 in support.

a century of South African company and securities jurisprudence, is that a security is comprised of *two interdependent legal objects*, so that each is indeed capable of *separate but simultaneous holdership*.[120]

The first object is, of course, the security asset, which is the locus for (holdership of) the totality of all substantive, or patrimonial, elements of the underlying interest. The second, the security instrument, is the locus for (holdership of) all incidents of execution of that underlying interest. These concepts are foundationally understood through the lens of the dual entitlements of determination and enjoyment that are holistically intrinsic to the underlying interest of any security. The instrument typically manifests physically as either entry on an issuer's register of holders (coupled with issue of an evidentiary security certificate), or by means of electronic ledger entry in the uncertificated securities register. As will be shown in the following chapter, where a certificated security is exchanged for an uncertificated security instrument or where a security has been issued in uncertificated form, there are important effects on the nature of the security asset and instrument, but the first principles articulated in this chapter remain substantially unaffected.

The function of the security instrument is to bestow on its holder the ability to realise and enforce content of the rights and competencies underlying the security itself. The underlying interest is, at its core, a specific legal relationship between security-holder and issuer, and as a result the "execution" in question is to be understood primarily with reference to the issuer. Thus the incidents of execution are those which enable the instrument-holder to: (1) realise and enforce performance in terms of rights, and (2) compel compliance in terms of competencies.

The term "execution" is used for a number of reasons. First, it is the best denotative option for all that flows, on the level of incidents, from an aggregated entitlement of determination (*beskikkingsbevoegdheid*) held over the collective rights and competencies that form the underlying interest of a particular security.

Second, "*beskikking*" could be directly translated to "disposal", "arrangement" or "determination" – it is difficult to capture the same nuance in English. However, the former two are the least contextually appropriate or insightful. The concept of a *beskikkingsbevoegdheid* implies an enabling or empowering proximity to the *realisation and enforcement* of the content of the right (to the exclusion of others), but without its counterpart – the ultimate entitlement to enjoy the economic value, or patrimony, inherent to such a right (the *genotsbevoegdheid*). Therefore, the usage adopted here is the entitlement of *determination*, and accordingly the functionalities (or rather incidents) that flow

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120 This is dealt with more fully in § 4 3 2 below.

from this entitlement all have to do with the enforcement and realisation of such value – i.e. the ability *to execute the contents of the underlying interest*.

Third, in the term there is a useful connotative analogy to that of the "executor" of an estate – an executor is bestowed with the power to perform all juristic acts related to the realisation of the value locked up in that estate, without any ultimate entitlement to that value. So too it is with the holder of the incidents of execution of a security.

Fourth, it adequately distinguishes the elements of rights and competencies which facilitate control, from control itself. This is of critical importance in properly dealing with the proprietary aspects of securities, where the notion and functions of control in the legal sense must be very clearly and carefully defined and understood. This is dealt with in § 4 3 below.

One of the requirements for valid issue of securities is the creation of a security instrument (whatever its form), as the legal intervention necessary for a security to come into existence.[121] Inherent in the constitutive arrangements of all securities is the consequence that the issuer will only be bound to recognise and perform towards the security holder of record, irrespective of the ultimate rights holder. This is true regardless of whether the constitutive arrangement is statutory, contractual or a combination of the two. Statute, and to a lesser degree common law, further provide this "holder of record" with the ability to exercise remedies, rights and other competencies against the issuer.[122] The ultimate holder of the underlying interest remains the holder of the substantive (i.e. patrimonial) interest in the security, but the proximate ability to execute that interest – i.e. factually exercise these rights and competencies – *vis-à-vis the issuer* lies, at least as a quite consistent point of departure, with this holder of record.

This is the unique structural property of securities' underlying interest. Upon issue, whatever their source, the totality of the incidents of execution within a security's bundle of underlying interests *does not lie with the ultimate rights holder unless that person is also the holder of record* (a division, where provided for, between asset- and instrument-holders upon issue is typically regulated in the acquiring agreement).[123]

This view is also supported, if not uncontentiously, by case law. In *Kruger Investments Group Ltd v Nuberry Holdings Limited*,[124] it was averred that an (English law) equitable owner of South African

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121 See § 4 2 hereafter.

122 For example, the holder's rights to apply for protection of rights in s 161 of the Companies Act, or dissenting shareholders' right, in certain cases, to a fairly appraised offer for re-purchase in terms of s 164 of the Act.

123 See § 4 2 for more on issues in the primary market.

124 (unreported, WCC 14184/15 [2015], [2015] ZAWHC 159, 30 October 2015).

shares, not registered as shareholder in the securities register, did not have the obligationary equivalent of "full" ownership of the shares in question. In this regard, the court held that:

> "In terms of s 37(9) of the Companies Act, 71 of 2008, [the respondent] is entered as a shareholder in the securities registers of Tyrecore and Falck. Pursuant to the definition of "*shareholder*" in s 1 of the Companies Act, [the respondent] is therefore a shareholder for purposes of the Companies Act, having certain rights (such as the right to attend shareholders' meetings and to vote) to the exclusion of the applicants. If the applicants are the owners of the shares, they do not enjoy the full effect of ownership because [the respondent] is the registered shareholder. In these circumstances the applicants can only obtain the rights currently held by [the respondent] if the applicants are successful in the main application and the securities registers of Tyrecore and Falck are amended to reflect the applicants as shareholders."

Though the judgment is criticised for its application of the principles of (or rather more accurately the incorporation of the legal position of) another jurisdiction in making its domestic law determination, *implicitly* the case provides support for the notion that "where registered title is separated from beneficial ownership *and that the registered title detracts from beneficial ownership*…*registered title is proprietary in nature*."[125]

As an example, when listed securities are issued in uncertificated form, the (registered) holder of record, from the moment of the inception of those securities, is typically a Central Securities Depositary (CSD), a CSD Participant (CSDP), a client (typically a broker) of the aforementioned, the asset-holder in own name (though less typically), or a nominee of one of these parties. With the sole exception of the facilitation of full uncertificated *security*-holdership in own name, the end-of-chain investor only ever receives the beneficial interest, but does so at the moment of issue. Any primary market acquirer (of a certificated or uncertificated security) thus becomes, after acquisition by issue, either: (1) both asset- and instrument-holder (i.e. security-holder), or (2) only asset-holder, with authority over the instrument-holder through not only the relationships created by an interceding chain of intermediaries, but also directly due to the posited underlying structure of securities.[126]

Securities, as a significant concept in South African *law* (rather than commerce), is quite modern,[127] and before the term had material legal significance the operative constructs were simply "shares" and "debentures". It is not necessarily argued that the security instrument has always been a feature of the positive law (although it may have been), but rather at the very least that legal development has brought the law to a point where the manifest legal qualities of securities justify its recognition.

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125 Yeats et al *Commentary 2008* 2-671.

126 See Chapter 5 generally, § 4 3 1 below, as well as Chapter 3, § 3 2 1 2.

127 See Chapter 3, specifically § 3 1 3 2.

The origins of the security instrument are found in company law, specifically relating to shares, in s 27 of the Companies Act 46 of 1926. This provision read that "[n]o notice of a trust, expressed, implied or constructive shall be entered on the [share] register or be receivable by the Registrar.", and came directly from English law.[128] As seen above, the English law concept of trust allows a separation of legal and equitable ownership. The provision was, accordingly, interpreted to mean that an issuing company was empowered and obliged to ignore all relationships of "trust" (and consequently any "equitable" title) and have regard only to the "legal" (i.e. registered) owner of a share.[129] The Report of the Lansdown Commission[130] caused amendment of the provision, introducing a formulation which was retained in s 104 in the Companies Act of 1973. This read "[a] company shall not be bound to see to the execution of any trust, whether express, implied or constructive, in respect of any share."

Naturally the English notion of trust and dual-ownership has long since been rejected in South Africa.[131] Yet reading it to include trusts in the technical South African law sense, as well as relationships of agency,[132] allowed the section to have approximately the same effect. Thus "a company shall concern itself *only* with the registered holder and not with the owner or beneficial owner of the shares."[133] In this manner South African law inherited the English position with minor differences, and the issuer of shares needed only to perform towards the person who was to be found on the share register. This may be referred to as the perspective of the company (or more broadly the issuer), to indicate that a legal dispensation *different* to that of the positive law's ordinary position vis-à-vis a performance-debtor and -creditor *inter se* is operative between an issuer and registered holder of a security. Illustrative in this regard is the following:[134]

> "As a result, from a practical perspective, the relationship between a nominee and the 'beneficial owner' in regard to the rights attaching to the relevant shares is influenced by the perspective from which one is approaching it. When viewed from the beneficial owner's perspective, the rights attaching to the shares are generally regarded as vested in and accruing to, or for the benefit of, the 'beneficial owner' notwithstanding that, in relation to the company, only the registered member can enforce them. For example, dividends received by a nominee are regarded as accruing to the 'beneficial owner', even though the company only

128 Blackman et al *Commentary* 5-297 – 5-299, and Yeats et al *Commentary 2008* 2-571.

129 *Inland Revenue Commissioners v J Bibby & Sons Ltd* [1945] 1 All ER 667 671; *Pender v Lushington* (1877) 6 ChD 70 76-77; *Pullbrook v Richmond Consolidated Mining Co* (1878) ChD 610 615; and others as discussed in Blackman et al *Commentary* 5-297 & n 3.

130 U.G. No. 45 1936 para 122 – see also Chapter 3 § 3 1 2.

131 *Lucas' Trustee v Ismail and Amod* 1905 TS 239 247-248, and *Princess Estate and Gold Mining Co Ltd v Registrar of Mining Titles* 1911 TPD 1066 1078.

132 *Sammel v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A) 666D-E; *Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd* 1976 (1) SA 441 (A); *Standard Bank of SA Ltd v Ocean Commodities Inc* 1978 (2) SA 367 (W) 370H.

133 *Sammel v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A) 666.

134 Yeats et al *Commentary 2008* Int-68.

has to pay the nominee and only the nominee can claim them. When approached from the company's perspective, the company is effectively 'blind' beyond its register and generally regards the registered shareholder as the person that is exclusively entitled to exercise the rights attaching to the shares and will not acknowledge the 'beneficial owner' as having any standing in relation to the shares."

Of crucial importance, for present purposes, is that from early on debentures *emulated* the effect of s 27, and thereafter s 104, by inserting a provision in the terms of issue that entitled the company to recognise only the registered holder of the debenture to the exclusion of all others. This remains an important feature of debt securities today.[135] Thus the concept of a splitting of registered title and beneficial ownership via a register of holders became common to all shares and debentures, as the legal progenitors of modern securities.

During the second half of the 20th century, South African law (and other jurisdictions) experienced an ascendancy of the securities concept, as inclusive of shares, debentures, and later perhaps also other securities.[136] As a result, a register of holders, as an exclusive record of the person toward whom to perform, had become a feature of *securities* (though for companies separate registers were maintained for shares and debentures). During this same period, for various macro-economic reasons, trading of non-equity securities began to increase rapidly in volume and velocity;[137] further, the old regime of paper-based trading became increasingly overwhelmed by this escalation in trading.[138] International systemic reform, pushed by the so-called Group of Thirty[139] began to be implemented in response.

In jurisdictions (1) whose securities and company law is primarily based on English law and (2) where securities are not considered negotiable, this reform was pursued through adjustments to the function of the register of holders (and registered holdership).[140] This has been typified as a result of "doctrinal path dependence" – jurists tend to effect legal reform along the path of least resistance, or change, to the underlying doctrinal structure of those jurisdictions.[141] South Africa, as one of these jurisdictions, caused this reform to occur in three stages.[142]

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135 See Chapter 3, § 3 1.

Further, from Chapter 6 it will become clear that if a debt "security" does not have this attribute, it very unlikely *classifiable* as a security in the first place.

136 Specifically outlined in Chapter 3, § 3 1 3 2.

137 See Chapter 2, § 2 3 2.

138 See Chapter 3, § 3 2 1.

139 Group of Thirty *Clearance and Settlement in the World's Securities Markets* (1989) was specifically influential.

140 See Chapter 3, § 3 2 1 2.

141 See E Micheler "English and German securities law: a thesis in doctrinal path dependence" (2007) 123 *Law Quarterly Review* 251.

142 This is fully outlined in Chapter 3, in § 3 2 1 2 and § 3 2 2.

First, in 1992, the legislature introduced the Safe Deposit of Securities Act.[143] This act allowed for the immobilisation of listed securities, by transferring registered title of the securities in question to a licensed central securities depository. Second, in 1998, the act was amended (thereafter titled the Custody and Administration of Securities Act).[144] This allowed for the dematerialisation of securities into uncertificated form by replacing the issuer's register with an electronic ledger maintained by a central securities depository or one of its participants. Certain amendments, most notably the insertion of s 91A, to the Companies Act of 1973 were also effected to facilitate this. It was argued in Chapter 3 that this alone allowed *all* securities to have been issued or converted into uncertificated form, but this was not the generally accepted view.[145] Thus, third, only in 2004 with the passing of the Securities Services Act[146] did it become uncontentious that all securities could be issued in uncertificated form.

The impact of these reforms on the notion of registered "ownership" was significant. For the first time, all securities could be held in *either* certificated or uncertificated form. Issuers of securities remained bound to perform only towards the holder of record – whether indicated in the issuer's register, or the uncertificated securities register. However, it must be noted that in many respects these changes did not adequately consider, or address, key doctrinal differences between English law and South African law, leading to a number of still persistent issues regarding uncertificated securities. This is dealt with at length in the following chapter and need not be pursued here.

Before these interventions, a convincing argument could still be made that registered holdership of shares and debt securities was a mere legal fact (prima facie evidence of ownership of a security), with limited legal consequences (for example determining the *locus standi* to enforce performance, the *lex situs* of the security, or the proximate capacity to exercise remedial rights). This legal fact informed the exceptionalism with which the position of the issuer was formulated, justifying in most instances the absence of any actionable nexus between issuer and beneficial interest holder not registered in the securities register (or before that, share and debenture registers respectively).

After these interventions the interest which register entry confers begins to look less like a legal fact enabled by s 104 of the Companies Act of 1973 and contractual provisions in debt securities, and more like an *object* with roots in substantive law and distinct features of holdership. The beneficial interest is able to change hands independently of registered holdership. Registered holdership is able to change hands independently of beneficial ownership. One contains certain elements of substantive rights and competencies, the other contains *other elements of those same rights and*

143 85 of 1992.

144 38 of 1998.

145 See Chapter 3, § 3 2 2 1.

146 36 of 2004.

competencies. Further the ordinary, plain language meaning of the words "custody" and "deposit" imply some sense of care and control over an *object*, and it would be unrealistic to ignore that (1) securities are generally considered to have a proprietary dimension, and (2) this proprietary dimension informs the commercial reality, most notably the commercial (but often also legal) tendency to talk of "ownership" or "buying" and "selling".

However, due to the incorporeality of a security as the holistic, proprietary object in question the law itself (as shown in Chapter 5) had to make use of an abstract (and in many ways artificial)[147] construct to simulate the consequences of what it termed "deposit", "custody" and "control", and in this way make legal sense of a phenomenon of reality that did not readily fit into its underlying doctrinal structure.

From this bifurcation of registered holdership, it should be inferred that the law countenances a higher-order, abstract, conception of registered holdership that has (so far) manifested in these two ways – certificated and uncertificated. Thus it is argued that, at the very latest by 2004, the positive law regarding securities had reached a stage of development that justifies the postulation of a legal interest-conferring *security instrument* as one of the two components of a security and its holdership.

In the abstract, the security instrument can be characterised as the legal vehicle for all incidents of execution over the complex of underlying interests (i.e. rights and competencies). As argued, these incidents are best described as functionalities flowing from an analogue to the entitlements of determination and enjoyment over *all* of the securities' underlying rights as well as its competencies. It has typically (if not always) been made manifest by entry in the issuer's register coupled with issue of a security certificate, or by entry in the uncertificated securities register maintained by authorised participants of the particular central securities depositary and the depository itself.

If so, what is instrument-*holdership*? In the commercial law context, an "instrument" is a document conferring "title" to payment, but in the present context even this designation is perhaps too strict. An instrument here must rather be seen to have its more ordinary, plain language meaning as a method with which to accomplish something.[148] In this case, through removal of the incidents of execution from the remainder of the underlying interest and in so doing creating a second legal *object* capable of separate *holdership*, one is left with a legal *instrument* that enables its holder to accomplish the execution of the underlying interest.

Recent developments in the law pertaining to exchanges for the transfer of securities have therefore, fundamentally altered what form the physical manifestation may take, but the principle remains

[147] See comments by Borrowdale (1985) *CILSA* 45-46.

[148] See Chapter 6, § 6 1.

steadfast. Thus, to say that this legal construct is an "instrument" is to say two things. First, it is a higher-order abstract legal construct serving as a means to achieve a specific legal outcome. Second, its physical manifestation is indeed describable as a legal object conferring *holdership* of certain intangible relationships arising out of personal rights and other competencies. That is why characterisation as an instrument is appropriate.

If that is the case, what *are* the "incidents of execution"? The pledge-style security cession outlines a theoretically sound basis for the severance of all incidents of execution over a performance, through a limited cession of the entitlement of determination as a whole. This, with the added complexity of an emergent agency-dynamic, is the basis of the instrument component of securities. Already dealt with in some detail, it will merely be refined here.

In essence, instrument-holdership amounts to conferral, on the holder of the instrument as object, of all that is necessary to cause the issuer to act in such a way that the economic and other end-benefits of the underlying interest are realised. On the isolated subject-object-subject level, the entitlement of determination over the rights underlying a security must of necessity reside in the security-instrument. But securities are comprised of both rights *and* competencies. These competencies form part of the global legal interest of the security, so a similar limited power *as against the issuer* must also accrue to the instrument. This is why it makes more sense to analyse the instrument at the level of incidents, at which level this power is one of the functionalities of competency-holdership, and it is similarly severable as an incident of securities.[149]

The instrument-holder is thus able, to the exclusion of all others, to enforce and realise: (1) *performance* in terms of rights, and (2) *compliance* in terms of competencies (for example the recognition of a vote at a shareholders' meeting, the sending of a notice of a general meeting, or the provision of information that security-holders are entitled to upon request), from the issuer.[150]

As an illustration, consider a security, "X", the underlying interest of which comprises of rights A and B, and competencies C and D. The instrument will comprise of all elements of the legal relationships created by A, B, C and D which facilitate the factual, proximate, or direct realisation of what those relationships confer on the security-holder. The asset will contain the remainder: the ultimate substantive entitlement to, or mastery over, what the relationships created by A, B, C, and D confer.

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149 See § 4 1 generally, and specifically § 4 1 2.

150 See also Yeats et al *Commentary 2008* at 2-800, stating "where there is a separation of beneficial ownership and registered title, it could be argued that the 'right of action' vests with the registered holder who generally is regarded as having the exclusive authority to enforce the rights comprising a share."

This analysis facilitates a more sound and theoretically coherent understanding of the current legal position, which is typified by contemporary statements such as the following:[151]

> "While entries in the securities register clearly can be part of the evidence considered when determining who has beneficial ownership, it is stressed that the beneficial ownership of the securities can be separated from the registered title. While there are some loose South African judicial references to nominees being legal owners of shares and certificates evidencing ownership, the preferred view is that in South Africa the registered holder is not the legal owner, as is the case under English law. *Rather, the preferred view is that in South Africa the registered holder is vested with the rights attaching to registered title (which appears to be a proprietary interest but not ownership).*"

The instrument is said to manifest as entry of its holder on a register (sometimes coupled with possession of an evidentiary certificate) primarily because that entry is what facilitates a holder's *locus standi* to exact and enforce performance or compliance in any justiciable dispute. This "right to claim and receive",[152] as extended from rights also to competencies, guarantees a holder the ability to found a valid cause of action, which is the essential prerequisite to any incident of execution. Of course, the term "right" in the quoted text is not entirely accurate, as it is an incident of holdership of a complex of rights and competencies. No further description is necessary, as each individual security's underlying interest will determine which precise elements thereof must reside in the instrument.[153]

Lastly, this construct does not in any way contradict the well-established notion, aptly expressed in *Standard Bank of SA Ltd v Ocean Commodities Inc*, that:[154]

> "[t]here is an important legal difference between immovable property and movable property whether corporeal or incorporeal. In regard to immovable property, a court cannot go behind the register. In respect

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151 Yeats et al *Commentary 2008* 2-781 – 2-782.

152 Van der Merwe et al *Contract* 432 & n 379.

153 Yeats et al *Commentary 2008* 2-584 – 2-585 is helpful in this regard:

> "For example, in *Smyth v Investec Bank Ltd* the court concluded that only the registered shareholder had *locus standi* to institute proceedings under s 252(1) of the 1973 Act, and not the unregistered beneficial owner. Also, an unregistered 'beneficial owner' of a share cannot bring an application for the winding-up of a company. This was an important factor in the case of *Barnard v Carl Greaves Brokers (Pty) Ltd and Two Other Cases*, where Binns-Ward AJ made the rather progressive statement that an owner that was not registered as a shareholder could, in certain circumstances, apply for relief under s 252 of the 1973 Act together with an application to be placed on the share register. While *Lewis Group Ltd v Woollam* can be read as adopting a generous approach to a beneficial owner's standing in regard to the derivative action remedy in s 165, it is submitted it is not authority for a general broad interpretation of a 'holder' for the following reasons:
>
> - the judgment was clear that Woollam did not qualify as a shareholder in the strict sense (it simply adopted the view that regarding him as a shareholder was justified);
> - s 165(2)*(a)* is expressly available to not only a shareholder but also 'a person entitled to be registered as a shareholder'; and
> - Woollam's standing to make a demand was not seriously contested and therefore the issue was not fully ventilated."

154 1980 (2) SA 175 (T) 181-182.

of registered shares [as movables], a court can go behind the register to ascertain the identity of the true owner."

A court may look past instrument-holdership, manifesting as register-entry, of *any* security as an incorporeal movable in order to determine the identity of the asset-holder.[155]

There is one anomalous obstacle to the finalisation of this analysis – s 50(2)(b)(iv)(bb) of the Companies Act, which reads:

"(2) As soon as practicable after issuing any securities a company must enter or cause to be entered in its securities register, in respect of every class of securities that it has issued-

…

(b) with respect to certificated securities-

…

(iv) in the case of securities contemplated in section 43-

…

(bb) the names and addresses of the registered owner of the security and any holders of a beneficial interest in the security…"

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155 A brief discussion of three important judgments in Yeats et al *Commentary 2008* at 2-780 is also helpful to reference in this regard:

> "So far, the courts have not been quick to look behind the securities register. In *Monique Investments (Pty) Ltd v 167 Bree Street Newtown (Pty) Ltd* [unreported, [2015] ZAGPJHC 232] the court had to consider an application for access to information in terms of the Promotion of Access to Information Act 2 of 2000 and s 26(1) of the Act. The applicant asserted that the current securities register was incorrect and the applicant intended bringing an application for rectification. The court held that in the circumstances, the presumption in s 50(4) held unless and until rectification of the securities register was ordered. Predicated on this, the applicant was not regarded as a shareholder because it was not reflected in the securities register as the holder of shares, and accordingly, was not regarded as having *locus standi* for the purpose of an application for access to information in terms of s 26(1). This conclusion accords with the distinction between registered title and beneficial ownership and the court's traditional reluctance to go behind the securities register.
>
> In *Knipe v Master, Free State High Court, Bloemfontein* [unreported, [2014] ZAFSHC 145] the securities register was accepted as proof that Knipe was a shareholder of Schaapplaats 978 (Edms) Bpk (in liquidation) (Schaapplaats) and therefore had *locus standi* to bring the application to review and set aside the decision of the master of the high court to accept the third respondent's claim against Schaapplaats, and the court was not persuaded by the assertion by the third respondent that the applicant had ceded shares to another person.
>
> In *Von Siebel v Accentuate Limited* [2015 JDR 1182 (GJ)] the court held that the chairperson of the company was correct to disallow purported votes by an owner of uncertificated securities where the owner did not appear in the securities register or the register of beneficial interests. This decision can be read as supporting the conclusion that an undisclosed beneficial interest holder without registered title needs to be appointed as the proxy of the registered holder, or, where the registered holder is a juristic person, then as its duly authorised representative (e.g. in terms of s 57(5)), in order to be able to attend a shareholder meeting and exercise the votes attaching to the relevant voting securities."

It is submitted that this particular provision should read as *pro non scripto*. There is no need to discuss this in detail as the authors in *Commentary 2008* provide a compelling and complete account of why this provision makes little sense within the broader framework of the Act:[156]

> "It is unclear why the drafters thought it necessary in s 50(2)*(b)*(iv)*(bb)* to require the names and addresses of the registered owner and any holders of a beneficial interest in a debt instrument to be recorded in the securities register, as this appears to be unnecessary and inconsistent with s 56, which is directed at the disclosure and registration of beneficial interests in respect of all securities issued by certain companies to be included in a beneficial interests register. Section 56 does not refer back to s 50(2). This gives rise to some confusion. If s 50(2)*(b)*(iv) is read as a self-standing provision, then the specified details of all holders of beneficial interests in any certificated debt instruments must be recorded in the certificated securities register. This is in marked contrast to s 56(3), which only requires the disclosures of beneficial interests in securities issued by public companies, and s 56(7), which only requires a separate register of disclosures of beneficial interests in securities to be kept by a 'regulated company'…It also appears anomalous and absurd to require the beneficial interest of certificated debt instruments to be recorded both in the certificated securities register and then again in a separate register of disclosures pursuant to s 56(7). The foregoing strongly suggests that s 50(2)*(b)*(iv) was the product of a drafting error, as there is no apparent rationale for the divergent treatment of beneficial interests in certificated debt instruments. Perhaps this can be reconciled by reading s 50(2)*(b)*(iv) as subservient to s 56, only requiring the details of beneficial interests in debt instruments to be recorded in the register of disclosures to the extent required by s 56. Even if it requires a bit of a stretch, this would be a commercially reasonable interpretation that achieves the apparent purpose of the relevant provisions while removing the inconsistency and duplication.
>
> Another possible reading of s 50(2)*(b)*(iv) would be to read it as aimed at the situation where the company has appointed a trustee to hold the debt instruments for the holders of the debt instruments as contemplated in s 43(5). In this instance, the trustee could be recorded as the 'registered owner' (in the sense of registered title only) with the beneficial interests of the 'holders' (in the sense of the vested beneficiaries) being recorded. This does, however, require a very loose reading of the respective references to 'holder' both in s 43(5) and s 50(2)*(b)*(iv). Ordinarily, the holder of a security is the person recorded in the register as the holder of the security (vested with the rights of registered title), but a loose reading may be justified because the term 'holder' is used in s 50(2)*(b)*(iv) with reference to both registered ownership and beneficial interests."

The proposed compromise offered in the final paragraph above is, with respect, unconvincing and has the unfortunate effect of further obscuring the technical denotations of the terms used throughout the Act. Accordingly, this work supports regarding the provision as a drafting error, and it will not be dealt with any further.

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[156] Yeats et al *Commentary 2008* 2-771 – 772.

Understood thus, the security instrument can be seen to serve a number of valuable functions, illustrating the value of referring to an instrument rather than falling back on the traditional conception of registered rights or, worse yet, registered ownership.

First and foremost, as a locus for the execution of the collective sum of rights and competencies, it facilitates the conglomeration, or bundling, of rights in cases where a security is comprised of more than one personal right. All rights and competencies accruing to a security must, by necessity, be administered *through* the instrument(-holder), so that these components of the underlying interest are bound together by it. This bundling function that the instrument serves will also become especially important in the next chapter when dealing with securities held collectively.

Second, it serves as a single locus of performance and compliance, which increases the economic efficiency of the capital-raising arrangement, and correspondingly decreases its economic costs over the lifetime of the borrowing arrangement. The issuer, as performance-debtor, need not incur any additional transaction-, monitoring- or information-costs in issuing, and thereafter tendering performance and otherwise administering the relationship. If securities were capable of fragmentation to the maximum extent possible in terms of their underlying interest and each holder of each fragment had, to some extent, to be recognised by the issuer, a potentially large multitude of persons with *disparate interests in individual securities* within a larger class or classes of securities would divide the attention and resources of the issuer far beyond the bounds of efficient capital raising.

Third, it fulfils an evidentiary function by evidencing both *prima facie* (through certification), and more definitively (through register entry) who the holder of securities is, and also to whom *performance* and *compliance* (regarding other competencies) is owed.

Fourth, the instrument construction informs and clarifies the concept of nominee-holding in the South African context. This is the crucial arrangement that allows securities to function in the complex and heavily intermediated transactional environment and infrastructure of the financial and exchange-driven marketplace. Whether nominee-holding is a function of the empowering legislation (for example the 1973 Companies Act, and more implicitly the 2008 Act) or of the terms of the security itself (for instance the required wording inserted into a debenture document under the older regimes or government debt securities currently),[157] this legal arrangement is one of the core elements of securities, allowing the trading of securities at a high volume and frequency in the financial system.

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[157] See Chapter 3, § 3 1 1 2; § 4 2 below; and, as another excellent contemporary example, paras. 2, 8, 9, 10 & 11 of the terms of issue of the RSA Treasury's R208 bond.

The security instrument, as an *a priori* structural feature of securities at large, can be seen to facilitate nominee-holding in a manner that satisfies these commercial needs.

Fifth, it greatly assists in the clarification of difficult issues arising from the proprietary dimension of securities. The application of legal rules and constructs which traditionally reside in the realm of the law of things (for example the usufruct, *quasi-rei vindicatio* or mandament van spolie) to these intangible phenomena create not only doctrinal friction, but more importantly legal uncertainty. A dual-construct of securities as inclusive of a separate *instrument* greatly aides an analysis of the precise application of this, in a sense appropriated, constellation of legal rules and constructs. This will be aptly demonstrated in the final section of this chapter in conjunction with some of the outcomes in Part 2.

Sixth, the security instrument as an abstract concept greatly assists with the classification of legal interests, especially if arising from contract, as "securities", if appropriate. This assists the law's ability to apply its rules and norms in a consistent and predictable manner and is the subject of Chapter 6.

Seventh, and most importantly in the context of this more theoretical chapter as well as the next, it fulfils a doctrinal harmonisation function. It allows South African law, which does not countenance dual ownership in the English sense, to explain coherently the *simultaneous* holdership of what traditionalist private lawyers would characterise as the same underlying interest (comprised of personal rights and competencies) by two different legal subjects. It does so by showing that each of these two hypothetical legal subjects simultaneously hold *different subsidiary components* of that underlying interest *as separate legal objects*, and thus have entirely heterogeneous but interdependent types of holdership.[158]

Lastly, it also provides a useful basis for understanding *duties and obligations* that are imposed by security-holdership.

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[158] This is further expanded upon in § 4 3 2.

In this regard:[159]

> "[i]t should not be forgotten that a security often includes obligations, it being implicit that shareholders have the obligation to abide by the memorandum of incorporation [and in the case of debt securities the constitutive arrangement]. While the rights constituting a share may be ceded without registration of transfer, there is authority that the obligations are attached to registered title and can only transfer once registration is accepted by the company and transferred.
>
> [Thereafter in n 284: The distinction under English law is founded on dual ownership with the registered holder being the actual common-law owner (entitled to enforce the rights and liable for the obligations), with English trust law being applied in regard to the unregistered beneficial owner in equity law (the equitable benefit being transferable by assignment or trust law without notice to the company or acceptance by the company). The equitable beneficial owner is then generally required by trust law to indemnify the common-law owner holding the shares in trust. It is much harder to explain this under South African law with its unitary approach to property ownership that nevertheless recognises a separation of ownership and registered title, regarding the nominee not as the owner trustee but rather as an agent. Influenced at a functional level by the English law position, our courts recognise that ownership s*implicter* vested in the beneficial owner can be transferred by way of cession (not by constructive trust) without registration of transfer, but they rarely consider whether the ownership rights are divisible from the related obligations. Usually an agent would not be 'vested' with the rights and obligations it holds as agent for a principal, but influenced by English law, a nominee is generally regarded as having enforcement rights against the company and is personally liable to the company for the obligations…This raises the question whether the obligations owed to the company lie exclusively with the nominee and only the nominee can delegate the obligations by way of a transfer of registered title, or whether the obligations are actually obligations on the beneficial owner (as principal) to the company (as opposed to the beneficial owner having only personal liability to indemnify the nominee).]
>
> …
>
> The preferred view is that the balance of authority (influenced by the English dual ownership construction) appears to favour the conclusion that, generally, in the absence of a restriction the rights attaching to shares

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159 Yeats et al *Commentary 2008* 2-513 – 2-515, and importantly at n 282:

> "While some authorities prefer the later definition in *Standard Bank of SA Ltd v Ocean Commodities Inc* 1980 (2) SA 175 (T) focusing on the rights, the following definition provided by Farwell J in *Borland's Trustee v Steel Brothers & Co Ltd* [1901] Ch 279 is preferred because it recognises the obligations attached to and more complex nature of a share, save to note that no-par value shares are not measured by a sum of money:
>
> 'A share is the interest of a shareholder in the company measured by a sum of money, for the purpose of liability in the first place, and of interest in the second, but also consisting of a series of mutual covenants entered into by all the shareholders in accordance with s 16 of the Companies Act, 1862. The contract contained in the articles of association is one of the original incidents of the share.' (Cited with approval in *Smuts v Booyens; Markplaas (Edms) Bpk v Booyens* 2001 (4) SA 15 (SCA) para 14.)'
>
> See also *Commissioners of Inland Revenue v Crossman* [1937] AC 26 66; [1936] 1 All ER 762 787 (HL); *De Leef Family Trust v Commissioner for Inland Revenue* 1993 (3) SA 345 (A) 356; and the footnotes above under '(1) Interpretation' and the notes on the definition of 'shares' and 'securities' in s 1."

See also 2-800 – 2-803, including a valuable comparative analysis with respect to English law and the role of the Memorandum as a "contract" to which an instrument-holder becomes a party.

> can be ceded without registration of transfer and that obligations pass only on registration of the transfer. Where beneficial ownership is separate from registered title, generally the registered holder remains liable to the company for the obligations attaching to the shares but would be entitled to indemnification from the beneficial owner (who hopefully is not insolvent)."

Here, the instrument-construction supports, and indeed enforces, the view that these duties and obligations are operative between instrument-holder and issuer by excluding the asset-holder from direct dealings with the issuer. It also harmonises the tension between received English law principles and South African law in a satisfactory manner.

It is submitted that, due to the fact that the constitutive arrangement (though not necessarily the elements thereof which constitute the *acquiring contract* as dealt with in the next section) binds *instrument*-holder and issuer inter se, a unique feature of the security instrument is that any obligations flowing in the direction of the issuer accrue *wholesale* to the security instrument. The mere agency construction of the "separate and severable" view of South African securities does not similarly enable this position, as obligations cannot vest or accrue to an agent in the traditional sense, again illustrating the legal usefulness of the outcomes of this chapter.

In all of the aforementioned, what is proposed simplifies legal analysis. Positing an instrument, as a legal object in the true sense containing the totality of the incidents of execution of the underlying interest, (largely) does away with the need to make separate analyses of the position from the perspective of the positive law and the perspective of the issuer. The so-called reconceptualisation argued for serves to re-integrate these perspectives for the purposes of legal problem-solving and exposition, also elaborated upon in the final section of this chapter.[160] In the next chapter it also proves to be of great value in understanding uncertificated securities.

However, the use of instrument-holdership go further than merely making theoretical sense. If it is to be anything more than a mere idea, it must also explain more direct and concrete aspects of the law as it stands and also solve specific problems within that legal framework. Thus the rest of this chapter will discuss certain key features of the law related to security holdership, as viewed through the asset-instrument paradigm. The larger issue of problem-solving is left for Part 2.

4 2 The creation of securities and the meaning of issue

[160] See § 4 3 below.

How do securities and their underlying interest legally arise? When securities come into being in the primary market the underlying interest must somehow be *created.* This process is one of the most overlooked, and interesting, aspects in the study of securities.

It is uncontentious to assert that there can be no right without a right-holder, and a personal right is the *relationship* between a given performance and a legal subject, manifesting in a legal claim to performance. The previous section showed that a claim itself is capable of giving rise to individual incidents (e.g. *fructus*) or sets of incidents (e.g. all incidents of execution as found in the pledge *in securitatem debiti*), which flow from the two-fold content of such a claim.

It further showed that competencies, while slightly more complex, can be similarly analysed by analogy. Any competency of the type accruing to a security-holder can be characterised as a relationship between: (1) the security-holder and (2) something which must be done, abided by, or facilitated by the security issuer. This was referred to above as "compliance" with such a competency, although nothing truly turns on the precise term settled on. Two illustrative examples of compliance are the issuer's recognition of a voting company security-holder's vote at a shareholders' meeting, or the co-operation of an issuer in the exercise of an appraisal right in terms of s 164 of the Companies Act of 2008. Compliance so closely resembles performance in the strict sense as *dare, facere* or *non facere* that it is appositely comparable. Crucially, this allows a general analysis of securities to take place at the level of incidents.

There are significant differences between the creation of shares and other securities, but in both cases there are common elements that justify a generally undifferentiated initial legal analysis. In the creation of each of these types of securities there are invariably two different juristic acts. The first is a bilateral contractual act, entailing the conclusion of a binding contract, through offer and acceptance (as modified by applicable statutory law),[161] causing the prospective issuer of a security to perform by "issuing" the security, and the prospective security-holder to provide value, often referred to as "consideration", in the way of counter-performance.[162] For clarity and convenience this contract, including all its forms, will be referred to as the "acquiring contract". The contractual agreement does *not* bring the security into existence, nor does it necessarily (depending on the security in question) bring the underlying interest of the security into existence. These only provide

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161 See Chapter 3, specifically the comments made at the end of § 3 1 1 1. Further, in the case of subscription contracts, see Blackman et al *Commentary* 5-241 as stating that "[e]xcept in so far as they have been modified by the Companies Act, the common law rules relating to offer and acceptance apply to such a contract…".

162 In the context of shares this typically occurs through an "allotment" or, recently more appropriate, a "subscription" contract – see *Moosa v Lalloo* 1957 (4) SA 207 (D) 219 and Blackman et al *Commentary* 5-241 & n 2.

In the context of debt securities, methods vary but typically include specialised auctions, "private placement" or mere "purchase". Under the 1973 Companies Act's regime, the meaning of "shares" in s 1(1)(v), functioning in the context of offer, subscription, and issue included then-called debentures also. Clearly, the name of the contract does not matter, as all these methods entail principally the same rights and duties (as *essentialia*) as that of subscription, although the mechanism by which the subscription amount may be determined can vary greatly.

for the right to have a security created and registered in the name of the designated instrument- or security-holder to-be.

The question then becomes, what *does* bring the security and its full content into existence? The answer is a second, constitutive (i.e. "*regskeppende"*)[163] juristic act, known as "issue". Issue is legally problematic for a number of reasons. The first is that issue is generally not considered "a technical, but [rather] a mercantile term, and…may vary according to its context."[164] Thus, precisely *what* issue is, and *how* it occurs, needs to be better understood. Despite the above pronouncement, it is submitted that the word issue must, and does, have a legal, technical meaning (for much the same reasons as given for the view that the terms security and debenture must have discrete legal meanings). However, it is also true that what issue entails will vary depending on the nature of the security in question. Here a notable distinction exists between shares and other securities.

The law regarding shares is the most exhaustive source of South African securities jurisprudence, and many general, securities-wide principles can be *derived* from share-specific principles. If anything is to be learned about the issue of contractual securities, shares must be dealt with first, and then – with justification and modification if necessary – serve as persuasive authority for the legal position regarding the former. Obviously in a treatment of shares, the discussion is (primarily) bound to the Companies Act of 2008 and to some degree its predecessor.

The discussion will further be limited to the issue of shares for consideration, and exclude not only capitalisation shares and shares acquired in terms of options or conversion rights,[165] but also the requirements of Chapter 5 of the Act regarding offers to the public. It is submitted that what follows is nonetheless applicable, with the necessary modification, to the creation of shares in any of these contexts.

Although the rights created by shares are generally considered as personal,[166] it has been styled as "artificial" to consider the rights to be contractual in nature, as they flow from a multitude of collaborative sources including a company's memorandum of incorporation, applicable statutory provisions, and the common law.[167] Simply, shares are not contractual in nature. Thus they are more suitably characterised as personal rights *sui generis*. What does this imply for the creation of shares?

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163 See Lubbe (1989) 52 *THRHR* 485 490, and Chapter 3, § 3 1 1 2.

164 Blackman et al *Commentary* 5–256-4, and authorities cited at n 5 & 6 therein.

165 See s 39(1) of the Companies Act.

166 See for instance *Jeffery v Pollack and Freemantle* 1938 AD 1 14; *Botha v Fick* 1995 (2) SA 750 (A) 762; or *Cooper v Boyes* 1994 (4) SA 521 (C) 533-535; *inter alia*.

167 See PA Delport et al *Henochsberg on the Companies Act 71 of 2008* (SI 11 – 2015) § 35 158, and Van Der Walt & Sutherland (2003) *SA Merc LJ* 95 97.

As a definitive source in this regard, Blackman et al aver (correctly) that issue, as distinct from subscription,[168] is the act by the issuing company of giving full and unfettered control of the share to the subscriber, thereby: (1) *creating the share* as "an item of property"; and (2) completing the subscriber's "title" to the share,[169] irrespective of whether a share certificate has been issued.[170] As aptly stated in a readily comparable jurisdictional setting by the Australian High Court, and relied upon by the authors, it is:[171]

> "only upon issue, as distinct from allotment, that individual shares come into existence as separate items of property, a process which logically must include entry on the share register for without such entry there will not have been…'the investing of the shareholder with complete control over the shares.'"

This is undoubtedly also a correct reflection of South African law,[172] and is further supported by s 35(4) of the Companies Act of 2008, which "[confirms] the common law principle that a share only comes into existence upon 'issue'".[173]

However, in *Moosa v Lalloo*,[174] the court appears to have held that acquisition of the rights to share could occur without registration; this also appears to have been cited with approval in *Du Plooy NO v De Hollandsche Molen Share Block Ltd*.[175] It is submitted that due to what is outlined above and below, this position cannot be viewed as correct,[176] and pragmatic as the point may be, it also has no evident basis in the South African framework of private law rights and relationships.

Through use of the security instrument construct a much more precise understanding of the nature of issue can be posited. The security instrument (as one of the two components of securities) is the facilitator of the *direct or proximate ability to execute* the underlying interest of that security. It may therefore give rise to all the incidents of rights, and other competencies, which serve to do so. In the case of shares the security instrument manifests as entry on the register and issue of security certificate, or in the case of uncertificated shares its equivalent of uncertificated securities register

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[168] See also Delport et al *Henochsberg 2008* § 38 172(4), citing *In re Ambrose Lake Tin & Copper Company; Clarke's Case* (1878) Ch 8 635 (CA) 638; *In re Biltong Asbestos Co Ltd* 25 CPD 356 361; *R v Brand* 1911 CPD 136 141-142; and *Bavasa v Stirton and Another* [2014] 2 All SA 51 (WCC) [38].

[169] Blackman et al *Commentary* 5–256-4 & n 7-8, and 5–257.

[170] *R v Brand* 1911 CPD 136 141-142, contrasting issue of a share with the issue of a certificate.

[171] As per Aiken, J in *Federal Commissioner of Taxation v St. Helens Farm (ACT) Pty Ltd* 1980 146 CLR 336 427 (HC of A) – as cited in Blackman et al *Commentary* 5–257 & n 3.

[172] See Blackman et al *Commentary* 5–256-4, and currently Delport et al *Henochsberg 2008* § 35 163.

[173] Delport et al *Henochsberg 2008* § 35(4) 163.

[174] 1957 (4) SA 207 (D).

[175] 2017 (3) SA 274 (WCC).

[176] Yeats et al *Commentary 2008* at 2-589 also notes that "it is open to debate whether the judgment was using 'shareholder' in the sense of a beneficial owner of the shares or an actual shareholder."

entry. It is submitted that the creation of the instrument is an immutable prerequisite for the existence of a security and thus all of the security's content (including the security asset).[177]

The reason it is a prerequisite is the nature of that which the security instrument provides its holder. Personal rights are relationships between a legal subject and the specific legal object of performance, and that relationship takes the form of a "legally valid *claim* by a legal subject to a legal object".[178] Not only can there be no right unless there is a legal subject as right-holder, there can also be no civil obligation if there is a right-holder in principle, but no-one the performance-debtor can be legally coerced to *perform towards* directly. These are both prerequisites to a valid and enforceable claim as the substance of a personal right, which is, in turn, a prerequisite for the creation of a security.[179] Conversely, if a security were to be putatively issued to a non-existent person, no issue can be said to have effectively taken place because until an existing legal subject is identified as performance creditor, no obligation (or more accurately no complex of rights and other competencies) can be said to have been created.

Thus, without the creation of an instrument the issuer is not bound to perform towards anyone – the instrument, through bestowal of the incidents of execution, *determines the performance-creditor*. Similarly, other competencies not readily classifiable as rights are subject to the exact same analysis. No enforceable competency can exist if the proximate "executer" of that competency is not yet identified, and without the creation of a security instrument this is not possible.[180] This is why, although stated in the context of shares, it is true of all securities that "…the rights only come into existence if [they are] capable of being exercised against the company".[181]

However, it does not follow that the mere creation of a security instrument will always and automatically also bring the applicable underlying rights and competencies into existence. It has also been settled that:[182]

> "the placing of the applicant's name on the register of members does not constitute an issue of shares allotted when something more is required to complete the applicant's mastery over the shares. Thus where

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177 In the context of the Companies Act of 2008, especially s 56, this is a contentious statement but must, it is submitted, nonetheless be accepted for a holistically sensible understanding of securities.

178 Du Plessis *Introduction* (1999) 140 & 143-144 [own emphasis].

179 Natural obligations are legally valid despite their general unenforceability – see for instance Van der Merwe et al *Contract* 3-5. However, it would border on the ridiculous to entertain the notion that the law would allow something as financially oriented as a security to be founded on a natural obligation.

180 See also Yeats et al *Commentary 2008* 2-280 on s 35(4) in this regard.

181 Delport et al *Henochsberg 2008* § 35(4) 163, based *inter alia* on: Van Wyk de Vries Main Report para 38.01; *Oswald Tillitson Ltd v IRC* [1933] 1 KB 134; *Brotex Cellulose Fibres Ltd v IRC* [1933] 1 KB 158; and *Murex Ltd v IRC* [1933] 1 KB 173). The original wording is "it is", which probably refers to the "…'conglomerate of rights'…" mentioned earlier, and only the grammatical concord error is corrected in the paraphrasing above.

182 Blackman et al *Commentary* 5–257 and 5–258 & n 1. This is in keeping with the dominant information theory governing valid offer, acceptance and the arising of consensus.

notification to the applicant of the company's acceptance of his offer is necessary to complete the contract of subscription and the applicant has not received such notification, the allotment of the shares to the applicant in response to his application and entry of his name in the register of members does not amount to the 'issue' of the shares to him. For until notification there is no contract, and therefore the applicant is not yet master of the shares."

This would appear to imply that the valid creation of a share by "issue" can otherwise only occur if there also is a valid and operative *causa* (i.e. legal basis) enabling the *lawful* creation of the rights and competencies of a security. According to the above, if there is not yet a valid *causa*, the applicant is *not considered a shareholder*, as the "mastery" requirement has not yet been met (albeit for a different reason). Typically, the *causa* would be the valid conclusion of, *and* performance in terms of, an acquiring contract.[183]

Without a shareholder there is no legal subject in whom to vest any claim to the object of performance, and consequently the creation of rights or competencies cannot occur. Further, there can undoubtedly be no incidents of rights if there are no rights to begin with. Thus, without a valid *causa* for the concomitant creation of the security's underlying rights and competencies, this amounts to the meaningless entry of someone's name in the securities register, and not the physical manifestation of the coming into existence of an actual (abstract) security instrument. In other words, but for this *causa*: (1) there are no rights from which to sever and allocate the incidents of execution, and (2) there is no basis for the positive law to give rise to other *ex lege* competencies accruing to securities, and from which to sever and allocate their respective incidents of execution.

This brings one to the highly problematic wording of s 50(2) of the Companies Act of 2008, which states that "[a]s soon as is practicable *after* issuing any securities a company must enter or cause to be entered in its securities register…" [own emphasis]. This section is applicable to all securities. As a point of departure for the broader inquiry, what does this imply for the issue of shares?

The Act appears to consider a security issued *before* entry on the register. This simply cannot be the case. In addition, it was recently confirmed in *Bavasa v Stirton and Another*[184] (with reference to various authorities) that mere delivery of a certificate would not complete a holder's "title", and thus

183 In terms of this acquiring contract, Yeats et al *Commentary 2008* 2-305 – 2-306 provides as follows:

> "When shares of a company are acquired from the company, this is done by way of a contract, not to purchase them, but to subscribe for them. This contract has been referred to as a contract of 'subscription' or 'allocation'. Except in so far as they have been modified by the Act, the common-law rules of contract relating to offer and acceptance apply to such a contract; consequently the general rule is that no particular form of agreement is required, and the contract may be effected in any manner in which a contract may be concluded, i.e. it may be either written or oral, and in the latter case either express or implied.
>
> The contract entails the following elements: the company's offer for subscription; the subscriber's application; and the allocation of shares to the subscriber. It is fulfilled when the subscriber pays for the shares and they are issued to him."

184 [2014] 2 All SA 51 (WCC).

entry on the register is vital for the completion of the act of issue.[185] Furthermore, especially in light of the new Act having effectively done away with the notion of allotment, it is very difficult to imagine what kind of express or tacit juristic act: (1) could *follow* the conclusion of a subscription contract (which does not itself bring a security into existence), but *precedes* registration, and (2) still satisfies the mastery requirements for the valid creation of a share (on which the common law is clear). Of what would such an act constitute? By comparison, even the real agreement of ordinary cession (the epitome of an abstract *and* form-free right creating, or *regskeppende*, juristic act), still requires at least that the requisite corresponding intentions be made manifest by words or conduct.[186]

Section 50(2) can be remedied interpretively. The golden rule of statutory interpretation has always been "adherence to the 'plain words' of a statute *unless* this would lead to an absurdity or to a result contrary to the legislature's intention". The rule serves to preserve rather than subvert that intention.[187] The absurdity of the section in question is that it not only runs contrary to a very long-standing meaning ascribed by the positive law to the "issue", at least, of shares, but also does not make doctrinal sense. One must, nonetheless, still consider whether it may have been the intention of the legislature to change the state of the law as it stood before the Act's passage.

This is not the case. Section 35(4) states that an "authorised share of a company has no rights associated with it until it has been issued." Shortly thereafter, s 37(9) of the Act further states that:

> "[a] person
>
> (*a*) acquires the rights associated with any particular securities of a company
>
> (i) when that person's name is entered in the company's certificated securities register; or
>
> (ii) as determined in accordance with the rules of the Central Securities Depository, in the case of uncertificated securities..."

Read together, it would appear that the legislature, at least, intended for no rights to vest until entry of the shareholder on the securities register. Logically, there can be no security (neither an asset nor an instrument) without vested rights. In this light, it must be true that no security can be considered to have been *issued* until such registration. Thus s 50(2) can justifiably be read in a manner that replaces "after" with "in". Whilst this is not an elegant solution, it is the only solution which resolves

185 [39]-[45]. From what follows above it would appear that this is also in line with the approach of the 1973 Companies Act's regime.

186 See for instance Lubbe "Cession" in *LAWSA* § 152.

187 L du Plessis *Re-Interpretation of Statutes* (2002) 103-104 & the legion authorities found therein (specifically n 128).

the above-mentioned absurdity and one that (certainly historically) can be assumed not to run counter to what the legislature intended.[188]

From this, it becomes clear that the issue of shares has precise legal meaning, and consists of the following two elements: (1) the completion of a valid *causa* for the lawfully binding creation of the share's underlying interest (completion rather than existence, because all requirements for the creation of the security's underlying interest bar registration must be met); and (2) the manifest creation of the security instrument, causing those rights to vest in securities' specific and unique structure. This is the composite juristic act *that brings the share into existence* and must be completed before a share is issued. Neither one of the two on its own can effect this, as the *causa* does not cause the share's underlying interest to arise without the creation of an instrument, and *vice versa*.

Thus, while the word "mastery" above can mean either control or title, it is submitted that it actually means *both*. The underlying structure of shares, in conjunction with the doctrinal principles regarding personal rights, show that without a locus for the incidents of execution no rights (or other competencies) can arise, at least in enforceable form, and without *enforceable* rights and competencies there can be no incidents of execution to begin with.

The next question is whether a similar analysis can be made regarding the creation of other securities. Unfortunately, this area of law does not enjoy the same wealth of material as shares. There are also fundamental differences between the origin of the content of shares and other securities.[189] The primary difference between shares and other securities is the mechanism for their creation. Shares' underlying interest originates only upon valid issue, as the *sui generis* consequence of certain positive law arrangements made, primarily, through company law. The case of contractual securities is more complex, and the role of classification is much more pronounced.

Here one must distinguish between *consensual* rights (and in certain cases competencies) and *consequential*, *ex lege* competencies (and in certain cases rights). In this context consensual rights arise contractually (with the underlying purpose of the arrangement being to create a security), and this arrangement then forms the basis of that security. These are the foundational rights such as entitlement to the structured repayment of a capital sum and interest. Certain competencies may

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188 The view is also implicitly supported in Yeats et al *Commentary 2008* 2-673 – 2-674.

Further, at 2-304, the authors note that "[t]he strange implication of s 35(4) read with s 37(9)*(a)* is that the rights can exist even though they are not held by anyone. Clearly the rights can only be exercised by the registered shareholder or, in certain circumstances, by the holder of a beneficial interest in the particular shares."

The view put forward above resolves this tension.

See, finally, also § 4 1 3 above.

189 This discussion excludes interests in a collective investment scheme.

also arise contractually, of which the best example is *pari passu* ranking between holders of a specific class or classes of security in the *concursus* of creditors. The consequential rights and competencies that may arise do so *ex lege* because the legal interest *is classifiable as a security*, to which the positive law attaches a unique content and set of consequences.

Having recognised this, it can be said that there are three preconditions for the creation of a contractual security. The first is a contractual arrangement that bestows upon the ostensible security-holder a legal interest.[190] Second is classification, or at least classifiability, of that legal interest as a "security". The third, as is the case for shares, is the creation of a security instrument founded on that legal interest. Only at the moment that these preconditions are met do the *ex lege* (and mainly statutory) rights and other competencies associated with securities arise, *consequentially*, to that factual matrix as a security. Thus classification plays a central role in the coming into existence of the underlying interest of contractual securities. This is alluded to in the discussion of s 35 of the Companies Act (the "legal nature of shares") in *Henochsberg*:[191]

> "The nature and types of shares are defined in s 35 (s 1 *vis.* "share"). A share should be distinguished from "securities" (s 1 *vis.* "securities"). 'Securities' includes shares, but is a much wider definition and also includes '…debentures or other instruments, irrespective of their form or title, issued or authorised to be issued by a profit company'…The ambit clearly differs and so would the regulation of the Act depending on the 'instrument' (see e.g. ss 44 to 48). '[I]nstruments issued by the company may therefore include, e.g., options in respect of shares and allocation rights. However, the concept of "instruments . . . to be issued" presents a problem, as these instruments, whatever they may be, are not issued and do not give any right to the holder thereof *vis-à-vis* the company. To include these unissued instruments in the definition of "securities" creates uncertainty. It would be clearer to provide for 'instruments in respect of issued or unissued securities.'"[192]

Framing a security as a dichotomous construct comprising of an asset and an instrument (although not instrument in the sense meant in the quoted passage, but as an abstract locus for the holdership of the ability to execute the security, manifesting in a certain way) does much to clarify the problem

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190 As per Yeats et al *Commentary 2008* Int-92:

> "the common terms associated with a debenture would include the following:
> - the principal (capital) amount acknowledged as a debt, the interest payable and the maturity date for repayment of the principal amount;
> - a description of default events and an acceleration clause to the effect that if the company defaults, then the capital and outstanding interest will become immediately repayable; and
> - if secured, details of any security provided, for example over certain assets of the company and the related maintenance obligations and circumstances in which the security may be realised."

191 Delport et al *Henochsberg 2008* § 35 158.

192 PA Delport *Die Verkryging van Kapitaal in die Suid-Afrikaanse Maatskappye-reg, met spesifieke verwysing na die Aanbod van Aandele aan die Publiek* LLD thesis University of Pretoria (1986) 124 *et seq.*

stated above. However, the more nebulous classificatory problem remains. To illustrate this, consider the following three, highly hypothetical, examples.

In the first, a company's board agrees that the company is to borrow an amount from A, to be repaid with interest in one singe instalment after 36 months. According to the agreement, the company endeavours to record his identity on a password protected Excel spread sheet. It further stipulates that the company must be notified of any cession effected by A, as the company will only repay the loan to the person whose name is reflected in the Excel sheet. The agreement expressly stipulates that "despite any similarities, it is not the parties' intention that this arrangement be construed to have created a 'security' for the purposes of s 43 of the Companies Act of 2008."

In the second, a venture capital firm provides a company with R500m in start-up funding. The *quid pro quo* of the agreement is split into two stages. The first stage lasts 36 months, during which the venture capital firm will receive a majority of voting rights at all general shareholders' meetings. At the end of the 36 months the voting rights will terminate, but the firm may elect to receive the right to a fixed percentage of the company's net profits in perpetuity as an ordinary creditor, or elect to "redeem" (i.e. terminate) the arrangement in lieu of payment by the company of R500m free of interest, as a preferred creditor. The agreement further stipulates (1) that the venture capital firm's rights in terms of the agreement are non-transferable, and (2) that the arrangement creates a "perpetual debenture", and therefore may provide for voting rights in terms of s 43 of the Companies Act of 2008, and must accordingly be registered in the securities register and accompanied by a certificate.

In the third, a public company purports to issue five option contracts, doing so through private placement in order to avoid the requirements of making an offer to the public. The option contracts are structured as "swoptions", and the holder of the option may, in 24 months, choose to enter into a swop agreement with the company on pre-determined terms. These terms are that, during the duration of the swop agreement, the counter-party pays a fixed sum to the company every three months (the so-called fixed leg of the swop), and in return will receive an amount from the company calculated as a fixed percentage of the remainder of declared dividends after preference share dividends have been paid and subtracted (the so-called floating leg of the swop). The agreement stipulates that despite the arrangement not being classifiable as an option in terms of s 42 of the Companies Act, it is a s 43 debt instrument because the option makes it a performance-*debtor*, and thus the options can be issued as securities, in uncertificated form.

In the first example the arrangement is most likely, despite the averred intention of the parties, a security. However, more important is the fact that there is doubt. In the face of doubt, only an appropriate classificatory analysis can determine whether, despite the intention of the parties, a security has been created, and therefore whether: (1) the spread sheet will either be deemed part of the company's securities register or will have to be duplicated in the official securities register; (2) a security certificate must be issued; and (3) the other *ex lege* rights and competencies that flow from any factual matrix giving rise to a security, will arise.

In the second example, the conferring of voting rights will be entirely contingent on the arrangement being classified as a security or not, and whilst it is most likely a debt instrument for the purposes of s 43, there remains doubt, and thus classificatory analysis is vital. The third example is the most ambiguous. Here classification as a security will determine whether the company may issue the swaptions "as securities" and this will determine validity of issue in uncertificated form.

An appropriate classificatory methodology in hard cases (including the above), specifically by making use of the *Typenlehre*, is left for Chapter 6. Nonetheless, this illustrates that when it comes to securities which are not shares, classification of the legal interests bestowed by contractual arrangements "as securities" is a pivotal and *prior* element in the creation of those securities (though such a classificatory determination may, and probably will, only occur *ex post facto* in cases of dispute). It determines (1) whether certain given *ex lege* consequential rights, competencies, and even structural features of securities are in fact sanctioned by the positive law, or whether (by not being securities) such arrangements fail; or conversely (2) whether certain elements of an arrangement that *should* be classified as a security are missing and, since the positive law requires these elements to be present, must be read in.

This is the importance of classification as a prerequisite (albeit implicit) for the issue of contractual securities. The second main problem regarding the issue of these securities is when and how the various components of the underlying interest of contractual securities are created. It is clear that, as in the case of shares, a valid acquiring contract must be concluded. However, in the case of contractual securities, this agreement plays a more foundational role.

In all cases, there are three essential components of such an acquiring agreement. First, it must stipulate the consensual rights which will form part of the security's underlying interest. Second, it must provide for performance in the form of actual *issue* of the security by the issuer. Third, it must determine the counter-performance of the acquirer (i.e. consideration in the parlance of shares). However, arrangements creating contractual securities differ in complexity.

On the one end of the spectrum is a single document stipulating all the necessary terms, including *inter alia*: the performances that will serve as objects to the consensual rights of a security, the manner in which the security instrument will be created, and a firm counter-value that must be provided for acquiring the security (the so-called "issue price").

A slightly more complex arrangement might entail the creation of a document stipulating, *inter alia*, the consensual rights and the creation of a security instrument, but will include a provision providing only for a mechanism by which the issue price (i.e. the counter-value) will be made certain in future (for example a bond auction, which typically takes the form of a Dutch auction).[193] In such an arrangement, consensus regarding the acquiring contract may be present immediately because the price is at least ascertainable, but this is not true of all cases, and consensus may well only be obtained at a future date via the stipulated mechanism.[194]

In an even more complex arrangement, the issuer will create a general document, setting out *inter alia* only *pro forma* terms and conditions of all intended future securities, including the manner in which the security instrument will be created.[195] This is typically the case in a medium- or long-term bond or note programme. The issuer, for each successive issue, will then create a separate document setting out specific securities' exact consensual rights and the method by which these securities may be acquired, as well as the counter-value (or issue price). Here the former document will be incorporated by reference into the latter.[196] The intercession of a trust or a mere fiduciary payment agent, as well as the documentary arrangements effecting this, may even further complicate the arrangement. The question now becomes how concisely to describe the coming into existence of these securities' rights and competencies – i.e. describing the issue of contractual securities.

The core attribute that differentiates shares from contractual securities is that in the case of the former all rights and competencies arise simultaneously upon issue, *if* it follows the conclusion of a valid acquiring agreement (which does not itself create any of those rights). For contractual securities, this is not the case. Here, the acquiring agreement, either alone but mostly in conjunction with a further, supplementary constitutive agreement, serves as the *source* of the consensual portion of the underlying interest of these securities, whilst the creation of a security instrument causes only the supplementary consequential rights and competencies to come into being. This is what underlies the creation of a contractual security. Why?

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193 See for example paras. 5, 6, & 8-11 of the "Terms and Conditions", and para. 4 under "General", of the RSA R208 bond.

194 One of the requirements for the valid conclusion of a contract is certainty regarding performances and other material aspects of the contract – Van der Merwe et al *Contract* (2012) 192.

195 See for example the "Programme Memorandum Execution" of Steinhoff International Holdings' SA Bond Programme, specifically paras. 3-4 & 14-15. It is hoped that at least the purely legal elements of the company's bond programme remain sufficiently legitimate for use here.

196 See for example the "Amended Applicable Pricing Supplement" of 3 November 2015 of Steinhoff International Holdings' SA Bond Programme attached in Addendum E of this work, specifically the preamble, paras. 16-20 & 28, and "Responsibility".

With the exception of the so-called "qualifications to the will theory",[197] contractual rights can only come into being if consensus has been reached by the contracting parties. This occurs through offer and acceptance with the necessary *animus contrahendo*, provided there is compliance with all the contractual validity requirements.[198] Just as in the case of subscription for shares, in the acquiring contract of any contractual security there must be valid consensus through offer and acceptance by the issuer and the acquirer, or *vice versa*.

As seen above, this contract can comprise a complex scheme of multiple documents. Irrespective of its form, however, this contract always stipulates with certainty what the consensual rights underlying the prospective security will be, and that there is a (separate) right to an initial performance in the form of the issuing of that security. Thus, when the parties reach consensus on the counter-value for acquiring the security, they also reach consensus on: performance in the form of creation of the security, *and* the performances serving as objects of the consensual rights of the security. Do both sets of rights arise at the moment when the contract is concluded, or only the right to the issue of the security? Also, are both sets of rights, if they do arise at the time of the conclusion of the contract, immediately enforceable?

There are three possible options: (1) both sets of rights vest and are enforceable at the time of contract conclusion; (2) both sets of rights vest at the time of contract conclusion, but the enforceability of the second set – i.e. the consensual rights forming part of the underlying interest in the security – is postponed until issue, at which point the underlying interest of the security is complete; or (3) only the right to performance in the form of issue vests at the time of contract conclusion, and the vesting *and* enforceability of the consensual rights forming part of the underlying interest are postponed until issue.

There would appear to be dated case law in favour of the first proposition, namely that both *dies cedit* and *venit* for the consensual rights underlying the security arrive at the moment of conclusion of the acquiring contract. In *Coetzee v Rand Sporting Club*,[199] the court observed that "[t]he *obligation* undertaken by the defendant was to *issue* an instrument *acknowledging* certain obligations *and to fulfil those obligations*."[200] The court's focus in this case is the impact of delivery or non-delivery of the debenture document itself on the legal position inter partes (the word "instrument" in the judgement refers to a documentary "assignable acknowledgement of debt", i.e.

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197 See Van der Merwe et al *Contract* (2012) § 2.3.5, 28 *et seq.* – specifically so-called "objective corrective consensus" and *iustus error*, which may form the basis of a security's consensual rights. However, consensus by these alternative means does not fundamentally alter the analysis, and so will not be dealt with.

198 Van der Merwe et al *Contract* (2012) 7-8, 19-45 & 46.

199 1918 WLD 74.

200 77 [own emphasis].

the debenture).[201] The court is undoubtedly correct in stating that delivery or non-delivery of a security certificate does not impact the enforceability of the security's content unless the debenture is to bearer.[202] This is because enforceability is intimately tied to who may execute the rights and other competencies of the security, and the certificate does not facilitate execution: it is merely *prima facie* evidence of the holder.[203]

Thus the court makes it abundantly clear that the issuer of a debt security (a debenture in the parlance of the case) cannot evade its obligation to pay principal and interest merely by refusing to deliver the debenture certificate to the holder.[204] The court puts it as follows:[205]

> "If the refusal to deliver the instrument amounts to a refusal to carry out the obligations under it, it is clear that the plaintiff may elect to sue at once for damages or to wait until the date of fulfilment…If there is no provision as to redemption it may be that the company could redeem on giving reasonable notice, but I do not see on what principle it can be said that the company by refusing to deliver the debenture deed could evade its obligation to pay interest. Yet that would be the effect of holding that the plaintiff cannot sue for the rights he was to have had under that deed. To hold this would certainly be to hold that the defendant could take advantage of his own wrong, and the principle that you cannot take advantage of your own wrong is one which has been applied in our Courts more than once…In my opinion the agreement set out in clause 3 of the declaration bound the defendant to pay 12 [percent] interest on £1,600, and to pay the sum of £1,600 if it were demanded after and if the interest was one month in arrears. It also bound the company to give an instrument containing this obligation which the plaintiff was entitled to assign."

However, the court's position seems not to be that the club refused to deliver what would now be referred to as the security certificate, but rather that it refused to *issue the debenture* (which as per Chapter 3 at the time were one and the same thing). This is why the case appears to serve as authority for the proposition that all the issuer's obligations are enforceable as soon as the parties have reached consensus on the terms of the debt, and that the "issue" of the debenture is a mere subsequent formality.

Above, in the context of shares, it is argued that issue means creation of the security instrument and completion of all other requirements for its creation (the completion of a valid *causa*). *Coetzee* would appear, therefore, to be authority for the fact that in the case of contractual securities: (1) the

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201 77.

202 Cowen & Gering *Negotiable Instruments* 63-64 & 87; *United South African Association Ltd v Cohen* 1904 TS 733 738; *Randfontein Estates Gold Mining Co Ltd v Custodian of Enemy Property* 1923 AD 576 580-581; and *Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd* 1976 (1) SA 441 (A) 452.

203 Section 51(1)(c) of the Companies Act.

204 See also Blackman et al *Commentary* 5–330 – 5–331, supporting this position in terms of the Companies Act of 1973. There is little, other than *Coetzee v Rand Sporting Club* itself, to state that this is the case also for debt securities issued under the 2008 Companies Act.

205 *Coetzee v Rand Sporting Club* 1918 WLD 74 77-78 [own emphasis].

consensual rights come into being earlier, and (2) that they become enforceable immediately, irrespective of the issue of the debenture. The second proposition will be dealt with first.

This second proposition would be highly problematic if it were extended to issue as it is, or at least should be, understood today.[206]

The debentures of 1918 were *not* securities, as the securities concept was in its infancy. "Issued" at that stage of the legal development meant mere creation and delivery of the physical debenture instrument (i.e. document). It does not mean that today. Even the register of debenture holders seems to have been, at the time the judgment was delivered, of far less importance than it is today. Whilst the Company Debenture Act of 1895 was not applicable *in casu* (as noted in Chapter 3, this Act was not operative in the Transvaal, but more importantly the issuer was a club rather than a company),[207] it serves as a useful indication of the approach that the law had to this type of problem. The Act does not deal, as *Coetzee* does, with unsecured debentures.

Section 2 of the Company Debenture Act stated that:

> "[a]ny Company may from time to time *grant and issue* debentures *and cause the same to be registered* [in the Deeds Registry – s 1, "registration"; own emphasis] under this Act, and such debentures when duly registered shall as from the date of such registration operate…as a first or preferential charge in respect of so much of the property of the Company as shall be mentioned and described in such debenture…"

In section 6, a debenture-holder:

> "shall be entitled to enforce his rights under such debenture so soon as it shall be issued to him precisely *as though such debenture had been issued under section three* [providing for the registration and optional lodging of duplicate debentures at the Registrar of Deeds]." [own emphasis].

If the two sections are read together, it would appear that debenture-holder creditors were able to enforce their rights as soon as debentures were issued.

From the above, the issue of secured debentures seems to have meant creation and delivery of the debenture instrument and, whilst the real security operated from the moment of registration at the Registry, such registration did not affect enforcement of the holder's rights. The Act did not provide for the creation of a register of debenture holders by the issuer, merely for real security arrangements centred around the Registrar of Deeds (see s 3). There is no reason to think this conclusion would

[206] See § 4 1 generally.

[207] See § 3 1 1 1.

not apply equally to unsecured debentures, such that issue of unsecured debentures also meant mere creation and delivery of the documentary debenture instrument.

The later Companies Act 46 of 1926 was the first legislation to make mention of a register of debenture holders in s 92(1). In terms of this legislative scheme, this register seems to have operated in addition to registration of secured debentures in the Deeds Registry in terms of s 91. However, the latter form of real registration should not be confused with registration in the register of debentures, as it fulfilled an entirely different function centred on real security arrangements.

Real registration was vital to the issue of secured debentures in the early 20th century. Its principal aims were to inform the public of the manner in which the debentures were secured, and validly effect that security. It was not intended as a record of those who could exercise the rights encapsulated in the debenture.[208] This is because the economic function of a "debenture" – as a special documentary instrument, accessory to an agreement of loan – was to standardise and regulate the on-going relationship between creditor and company-debtor, and to augment the residual rules of contract (and other aspects of the common law) in certain desired ways. Its primary functions were to acknowledge the debt and to effect economically efficient real security.[209]

Therefore, on the construction of issue evidenced by the Company Debenture Act and its implications for enforceability, the *Coetzee* case appears to have been correctly decided. More importantly, it would indeed seem absurd to hold that non-delivery of an accessory document evidencing an indebtedness could affect the enforceability (or execution) of the underlying obligations – especially if the debenture were not operating in conjunction with a register of debentures.

The salient question then becomes whether the judgment is a correct reflection of the current legal position. Specifically, is it correct to rely on *Coetzee* to assert that contractual securities' rights are enforceable irrespective of whether issue of the security has been validly completed? For two main reasons, this cannot be correct.

The first reason concerns a change in the remedial regime for holders of contractual rights, occurring after the decision. The problem the court faced in *Coetzee* was that an order of specific performance was viewed, at the time and for some time thereafter, as an exceptional remedy, to be refused unless

208 Chapter 3, § 3 1 1 1 & § 3 1 1 2. This also seems to explain why the judgment makes no mention of a register of holders – irrespective of whether there was such a register (which there probably was), it was simply not determinative of the outcome of the dispute. Further, the reported judgment concerns an issue decided on exception. The actual dispute was not resolved.

209 As seen in Chapter 3.

reasons of equity strongly militated in its favour.[210] This legal position was only reversed in the late 20th century, when specific performance was re-established as a generally available remedy to any contractant preferring to see the obligations carried out rather than accepting damages, and to be *refused* only in exceptional circumstances.[211]

Specific performance, now firmly entrenched as the remedy of choice for contractants desiring fulfilment of the obligations over damages, would solve the problem of a modern plaintiff in Coetzee's position far more elegantly. Such a plaintiff could demand specific performance in the form of issue of the security, thereby obtaining the security instrument personally or through an agent, and using the control it bestows to enforce and realise the performances locked up in the underlying interest. This fully addresses the court's concern regarding an issuer's ability to benefit from its own wrongdoing.

The second, more fundamental reason for holding that *Coetzee*'s pronouncements on enforceability before issue are no longer appropriate flows from a more accurate theoretical understanding of the legal nature of modern securities, with which the reasoning in Coetzee has become incompatible.

It has been shown that through a series of 20th century legislative interventions, the legal nature and structure of debt securities (and to a degree all securities) had been radically altered, specifically as a result of the rise of the securities concept itself.[212] During the 20th century, as the focus of debt securities began to move away from real security and gravitate towards exchanges and trading, the role of what has now been identified as the security instrument gradually became increasingly important, more defined, and more sophisticated. The role of the register of debenture holders thus became increasingly important in relation to the certificate. Conversely, characterisation of a debenture as an accessory instrument augmenting a debt became steadily more inaccurate, as the asset and instrument components of the modern security are dependent on one another for their legal effect. The modern security situates the incidents of execution (and thus the means to enforce and realise the performances and competencies) of its underlying interest *within* the security instrument.

In the case of company debt securities, the law today requires the entry of debt security-holders into the securities register.[213] However, in the case of debt securities issued by other entities no law mandates a register of holders to which the issuer is bound to perform to the exclusion of all others.

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210 Van der Merwe et al *Contract* 330.

211 Van der Merwe et al *Contract* 330 and *Benson v SA Mutual Life Assurance Society*, 1986 (1) SA 776 (A) 783 as the watershed decision, coincidentally dealing with the delivery of shares.

212 Chapter 3, § 3 1 2 & 3 1 3.

213 Sections 1, 42(1), 43(2)(a) and 50(2) respectively.

Further, in the 1926 and 1973 Companies Acts, nominee-holding in the case of non-equity securities was also a matter that had to be addressed externally to the issue, as the company (in terms of s 27 and s 104 of the Acts respectively) was only free to ignore the "execution of a trust" in the case of shares.[214] Nevertheless, debt securities, in order to function efficiently in the developing (equity-dominated) secondary marketplace, began structurally to converge with shares and *emulated* this state of affairs through provisions *contained in the debt security itself*, such as:[215]

> "4. The registered holder will be deemed exclusively entitled to the benefit of this debenture, and the company and all persons may act accordingly. The company shall not be bound to enter in the register notice of or in any way to recognise any trust or the right of any person other than the registered holder to any benefit under this debenture save as herein provided."

Whether a contractual security is issued by a company or any other entity, the creation of the security instrument (typically manifesting as the creation and maintenance of a register of holders and issue of a certificate; or entry in the uncertificated securities register according to the provisions of the Financial Markets Act)[216] remains a matter that must be dealt with in the acquiring agreement of that security. This seems to hold true even for non-transferable securities such as retail savings bonds issued by the South African Treasury.[217]

As a result, much as in the case of equity securities, in terms of the acquiring agreement itself there is no *performance*-creditor until someone is entered into the register of holders, or some other arrangement is made to make a security instrument manifest. In short, no consensual rights arising from the creation of a security can possibly be enforceable unless there is a legal subject with the legal capability to enforce them. The only potential exception may be in cases where existing rights are, *subsequent* to their inception, made subject to the architecture of a security to be issued.

In spite of the arguments above, *Henochsberg on the Companies Act 71 of 2008*, who – after reviewing a number of definitions of debenture from various sources – states the following in terms of s 43 of the Companies Act.[218]

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214 In terms of s 27 of the Companies Act of 1926 and s 104 of the Companies Act of 1973 – both of which only applied to shares.

215 E Emmet *Pyemont's Company Law of South Africa* 5 ed (1940) 200 – an example chosen to illustrate that this development began early on, arguably originating from the 1926 Companies Act.

Of course, even if there were such a clause in Coetzee's debentures, specific performance would still remain an extremely exceptional remedy, and such a clause would in all likelihood exacerbate the unavailability thereof. This is no longer the case, as specific performance in the form of *issue* would place a plaintiff in a position to enforce the debt *through control of the instrument-holder* (see also § 4 3 2 1).

216 19 of 2012.

217 See for example the terms of issue of the RSA Inflation Linked Retail Savings Bond, specifically paras. 17, 18, 19 & 22.

218 Delport et al *Henochsberg 2008* § 43, 184(2) [own emphasis].

> "[I]t is submitted that, because the word "debenture" is not defined in the Act, a debenture, as defined in the common law, may be issued by the company *in addition to* a "debt instrument" (see s 1 *sv* "securities" and General Note on s 35). The provisions of s 43 should then *not* apply to this debenture. The meaning of a "debenture" is imprecise, but it has been interpreted to mean any document, however it may be described, and whatever form it may take, which creates or acknowledges indebtedness in the company to another for moneys advanced or to be advanced to the company…These definitions indicate that *the term "debenture" is used in respect of the written acknowledgement of debt rather than an indication of the underlying (lending) transaction*."

It could perhaps be argued, on this basis, that a debenture would still operate in the manner envisaged in the *Coetzee* case. However, this is not a correct view. First, more superficially, it makes little sense that a debenture may be issued (literally) in addition to a s 43 debt instrument – i.e. in a manner that the section should not apply to such an issue. Second, and more importantly, the arguments advanced in Chapter 3, as well as inclusion of debentures in the definitions of "security" in the Stock Exchanges Control Act of 1947, the Securities Transfer Tax Act of 1965, the Securities Services Act of 2004, the Financial Markets Act of 2012, and the current Companies Act itself make it difficult to accept this view.

However, alternatively, it may be that what is meant by "in addition to" is in fact "supplementary to" – i.e. as a documentary supplement to the underlying debt instrument. Taken in this way, the debenture refers merely to the (debt) security certificate. The debt security itself must then comprise of the debt instrument (the underlying loan and entry of the security-holder into the company securities register) and the debenture (the prima facie evidentiary certificate which completes the manifestation of the security instrument).

It is, respectfully, submitted that this is also unconvincing. The above view is certainly the correct one regarding the "debentures" envisaged in the 1926 Companies Act as augmented by the common law in force at the time.[219] This interpretation would further be understandable as, up to this point, the common law definition of debenture has never been revisited or subjected to any analytical critique. However, subsequent legal development (outlined above and dealt with fully in Chapter 3)[220] in conjunction with the analysis of the previous section does not support such a view. Supportive of the steadily mounting inappropriateness of this dated common law definition and approach is also the fact that debentures themselves were capable of being (and indeed were) traded *as securities*

219 See Chapter 3, § 3 1 1 1 and § 3 1 1 2.

220 § 3 1 3.

on BESA in dematerialised form at least from 2004 onwards.[221] Furthermore, in *Standard Bank of SA Ltd v Ocean Commodities Inc*, the court states that:[222]

> "[a]lthough the rights conferred by a debenture on a debenture-holder differ in content from those enjoyed by a shareholder, *similar considerations apply* to the registration of debenture-holders, the issue of debenture certificates and the holding of a debenture by a nominee."

In light of the facts of the case, this makes it quite clear that a debenture in the more modern legal sense must refer to the debt security in its totality, and the term can no longer merely refer to the "debenture document" (i.e. certificate).

Together, the above makes it doubtful that the legal nature of a 21st century debt instrument nominally referred to as a "debenture" ought to be subjected to – and thus determined by – a common law definition (a "written acknowledgement of indebtedness") that is, at the time of writing, 103 years old.[223]

For these reasons it is submitted that the second proposition in *Coetzee*, affirming enforceability – or rather executability – prior to issue, is undoubtedly no longer a correct one. This brings one to the judgement's first proposition – that the rights, although now shown to be unenforceable until issue, still *vest* upon mere conclusion of the acquiring contract.

Company securities remain bound to rules and principles of the Act, and s 37(9) is applicable to all securities. Consequently, all company securities are also subject to the legislative imperative of register entry for the coming into existence of rights. This makes the current legal position, as far as company securities are concerned, unequivocal. Although the acquiring agreement serves as the source of the consensual rights, there is an *ex lege* (and in fact statutorily imposed) suspensive condition attached to all such contracts, postponing both *dies cedit* (vesting of rights) and *dies venit* (enforceability of rights) until the moment when the primary market acquiring instrument-holder is entered into the register. The same arguments made above in the context of shares – to the effect that no personal right in terms of a security, i.e. no claim to performance as set out in the security,

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221 See Chapter 3, § 3 2.

222 1983 (1) SA 276 (A) 289 [own emphasis].

223 *Coetzee v Rand Sporting Club* 1918 WLD 74 76-77 for this definition; as well as FHI Cassim (ed) *Contemporary Company Law* (2012) 230-236; Blackman et al *Commentary* 5-327; and Yeats et al *Commentary 2008* 2-352 – 2-353. In the domestic literature, this description is typically accompanied by reference to the classical compendium of English, South African, and Australasian cases *Edmonds v Blaina Furnaces Co* (1887) 36 ChD 215; *British India Steam Navigation Co v Inland Revenue Commissioners* (1881) 7 QBD 165 172–3; *Levy v Abercorris Slate & Slab Co* (1887) 37 ChD 260; *Lemon v Austin Friars Investment Trust Ltd* [1926] Ch 1 17; [1925] All ER Rep 255 (CA); *R v Findlater* [1939] 1 All ER 82 85 (CA); *Knightsbridge Estates Trust Ltd v Byrne* [1940] AC 613 621–3; [1940] 2 All ER 401 405–6 (HL); *Handevel Pty Ltd v Comptroller of Stamps* (1985) 10 ACLR 207 218 (HC of A); *Austral Mining Construction Pty Ltd v NZI Capital Corporation Ltd* (1991) 4 ACSR 57 58 SC (Qld); and *Re SH & Co (Realisations) 1990 Ltd* [1993] BCLC 1309 1317–18.

is able to arise unless both the ultimate beneficiary *and* the legal subject who must be performed towards are certain – are also applicable here.

However, this may not be the case regarding contractual securities not issued by companies. The law of contract gives parties great freedom to build variability into agreements. It is therefore submitted that, depending on the intention of the parties as evidenced from the acquiring agreement and the surrounding factual matrix, the consensual rights of a non-company contractual security can either: vest with enforcement postponed until issue (i.e. *dies cedit* is immediate but *dies venit* is the moment of issue); or vest and become enforceable upon issue through the operation of a contractual suspensive condition that is in effect similar to s 37(9) of the Companies Act (so that both *dies cedit* and *venit* are postponed until issue). Admittedly, especially in light of the manner in which the law treats company securities, the latter view remains doubtful. Nevertheless, in either case, recognition of a registered holder to the exclusion of all others remains a central prerequisite for the valid creation of the security in question. At the very least it is impossible for *dies venit* to arrive earlier that the date of creation of the security instrument, and though certain rights may have vested prior to creation of the security instrument, no security can be said to have been issued prior to that act.

From the above, the only material difference between the issue of shares and the issue of contractual securities appears to be the effect of the acquiring contract. In both cases it serves as *causa* for the creation of a security – the reason for the coming into existence of a bundle of positive law rights and competencies. In the case of shares, the *causa* serves as a requirement for the creation of the security (by creating a personal right to be issued the security), but does not itself create any rights or competencies. In the case of the latter, this *causa* serves both as a requirement for the creation of the security and also, alone or in conjunction with an additional constitutive agreement or set of linked agreements, as the constitutive source of the security's consensual rights and perhaps also certain competencies.

Further, common to all contractual securities (irrespective of at which point the rights come into existence) is that *enforceability* of the underlying interest of a security will arise only upon creation of a security instrument – register entry (though the act of issuing the *certificate* may, factually, occur thereafter). The creation of the security instrument is the performance required in terms of *the personal right to issue the security*, as mandated by the acquiring contract. This performance causes the consensual rights either to vest, or vest and become enforceable, as well as causing the consequential rights to arise. Without a security instrument, there is no legal subject to perform toward, or who can claim performance in terms of the security. Thus, the creation of the security instrument "completes" the security, at which point it can be regarded as issued. This clarifies not only the term as found in sections of the Companies Act dealing either with contractual securities or company securities in general,[224] but also facilitates an understanding of non-company securities.

In conclusion, issue in the case of contractual securities is: (1) the valid conclusion of an acquiring agreement, serving as source for the security's consensual rights and *causa*, or lawful basis, for the creation of the security (by creating a further personal right to issue of the security); and (2) the creation of the security instrument. These two steps bring into existence, *ex lege,* the remainder of the security's (non-consensually arising) underlying interest, and cause enforceability of the full underlying interest to arise.

There is one type of security that has been conspicuously absent in this discussion – the participatory interest in a collective investment scheme ("ICIS"). The Collective Investment Schemes Control Act[225] does not contain any provisions dealing with the form that the participatory interests must take. It states that such an interest is:[226]

> "any interest, undivided share or share whether called a participatory interest, unit or by any other name, and whether the value of such interest, unit, undivided share or share remains constant or varies from time to time, which may be acquired by an investor in a portfolio…"

It further states that any "assets of an investor must be properly protected by the application of the principle of segregation and identification".[227] The form of an ICIS is thus innately variable. However, most ICISs take the form of shares in a so-called "open-ended investment company",[228] and are thus created through issue in the same manner as ordinary shares. Even other collective investment schemes that are labelled as "trusts", most notably REITS,[229] typically make use of the company form. However, even true trusts, which are seemingly viable as the vehicle for conferral of an ICIS, could cause a security instrument to be created in a number of ways, including through the trust deed in conjunction with the ICIS itself, or contractually in a manner analogous to the issue of purely contractual securities. A security instrument is, however, vital for the creation of an ICIS, as it must

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224 See for instance s 1 ("securities"), s 42(2)(a) & (3), s 43(1)(a)(i) & (2), s 44-45, or 49-52.

225 45 of 2002.

226 Section 1 – "participatory interest".

227 Section 2(2).

228 JW Scholtz & DW De Villiers "Securities Services and Collective Investment Schemes" in JW Scholtz (ed) *Law of South Africa* 2 ed (2015) Vol 26 § 155.

229 Real Estate Investment Trusts.

be capable of being held in uncertificated form,[230] which necessitates a separation of asset- and instrument-holder.[231]

Having established the meaning of issue, as the juristic act bringing securities into existence, the next section looks more closely at the legal nature of securities. It focuses specifically on the meaning, construction and nature of the security asset and instrument, respectively.

4 3 Consequent features of security-holdership

This final section will deal, on a principled basis, with three consequent theoretical aspects of (debt) securities.

First, it will deal with the nature of the relationship that exists between an issuer and separated asset- and instrument-holders of a security, the relationship between the latter holders inter se, as well as the various interceding relationships that can be interposed *between* the holders of a given security.

Second, it will use the asset-instrument dichotomy to give a more detailed account of the *proprietary* feature of securities. Specifically, it will discuss some of the more important theoretical legal problems in the realm of *factual* holdership, with specific reference to outlining a more suitable construct for what may correctly or incorrectly be referred to as quasi-possession. This will form the basis for the discussion of specific problems in securities law (most notably real rights, agreements and relationships).

Last, it will analyse more deeply the (as yet largely ignored) modern role of the security certificate of certificated securities.

Once again it bears mentioning that any critical differences that arise where a certificated security instrument is exchanged for an uncertificated security instrument or where a security is issued in uncertificated form will be dealt with in the following chapter, and will as far as possible at least be flagged in that which follows.

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230 Section 1 of the Financial Markets Act, in defining "securities", includes ICISs in ss (a)(v) and (b).

231 See also Chapter 6, § 6 2 and § 6 3 for similar analysis from a classificatory viewpoint.

4 3 1 The relationships between issuer, holders, and select third parties

This section deals mainly with the effects of separated asset-and instrument-holdership. The tripartite relationship which arises between an issuer of a security and separate asset- and instrument-holders is a difficult matter, further complicated by the related (but not synonymous) relationship between asset- and instrument-holders *inter se*.

Though the latter can be described as having "proximate control" over the security through control over the incidents of execution, the former holds the incidents flowing from the substance of the security's underlying interest, and must accordingly be able exercise control over *how* that underlying interest is executed. Thus, the asset-holder appears to have the privilege of "control over the executor". This is critical for the analysis below.

The position of both holders must be understood – and thus dealt with – separately before the totality of the consequences of these arrangements is clear. What follows also appears to be the second illustration, after the discussion of issue above, of the problem-solving, or at least elucidatory, qualities of the asset-instrument dichotomy posited here.

The global relationship between an issuer and respective asset- and instrument-holders of a given security appears to be one of agency,[232] in the narrow sense of *representation.*[233] Through holdership of the incidents of execution shorn of any substantive interest in such a security, it appears logical that the instrument-holder *represents* the asset-holder (as the holder of the security's patrimonial value) through her exercise of those incidents for the benefit, and subject to the directives, of the asset-holder. This seems true of all matters that arise between the issuer and the security in question. Only the instrument-holder is competent to compel the issuer to act in these matters, and even in cases of application for rectification of a securities register a court must restrict itself only to deciding who the true instrument-holder is.[234]

Yet in *Sammel v President Brand Gold Mining Co Ltd* the court, in discussing the impact of s 27 of the Companies Act of 1926, states:[235]

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232 *Sammel v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A) 666D-E; *Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd* 1976 (1) SA 441 (A); *Standard Bank of SA Ltd v Ocean Commodities Inc* 1978 (2) SA 367 (W) 370H; Blackman et al *Commentary* § 5-172 and § 5-171-2 in n 5; and Yeats et al *Commentary 2008* 2-569 – 2-571.

233 M Dendy "Agency" in WA Jourbert (ed) *Law of South Africa* Vol 1 (3 ed) 2014 § 125 (third paragraph), § 126 and § 133.

234 See for instance the comments of the court, regarding rectification, in *Verrin Trust and Finance Corp (Pty) Ltd v Zeeland House (Pty) Ltd* 1973 (4) SA 1 (C) para 13D-E.

235 1969 3 SA 629 (A) 666F-G [own emphasis].

> "no one can be registered as holding the shares as the agent for another; he, the agent, must himself appear on the register as the holder of the shares. Consequently, such a person came to be known in ordinary commercial parlance as the 'nominee' of the owner of the shares, probably because the word conveniently and usefully *synthesised the dual concepts that the person was nominated by the owner to hold the shares for him in his name and that he thus held them only nominally*, i.e., in name only."

Nonetheless the instrument-holder of an asset-holder principal meets the criteria for agency, as an agent is described as:[236]

> "a person who concludes a juristic act with the intention to create, alter or extinguish legal relationships for another person and not for him or herself."

Agency as representation, therefore, extends beyond mere representation in the conclusion of contracts on behalf of a principal, and (subject to certain exceptions) "all types of juristic acts can be concluded on behalf of another person by a representative."[237] This, in conjunction with the court's use of the term "legal relationships", seems quite important. As has been established, the security instrument bestows on its holder the incidents which enable the execution of the underlying interest – i.e. the performance of all juristic acts necessary to *realise and enforce* the underlying interest. The holder of the incidents facilitative of *enjoyment* of the substantive value or benefits of the underlying interest is not enabled to perform any of these juristic acts. Thus the former, who has no substantive interest in the security, must perform these juristic acts on behalf of the latter.

The (instrument-holder) agent in this case acts by virtue of her holdership of the instrument as legal object *in her own name*, but still *on behalf of* the (asset-holder) principal. This may, prima facie, appear problematic as it suggests, as per *Sammel*, a fusing of agency and mandate. Yet understanding incidents as *functionalities* flowing from interaction between (1) the "subjective rights and relationships" dimension of securities' rights and competencies, and (2) what is countenanced by the objective law in the exercise of legal subjectivity, resolves this issue. It is clear from the definition above that representation goes further than merely the creation of obligations in the name of another. A security instrument-holder, as described, *is* "a person who concludes…juristic act[s] with the intention of creating [through register entry], altering [for example in the exercise of competencies] or extinguishing [for example in receiving performances] legal *relationships*…" on behalf of the asset-holder. There is no discernible reason to hold that such an agency cannot arise from the deeper structural properties of an underlying interest, instead of by agreement.

Whatever combination of rights and other competencies the underlying interest of a security contains, the execution-functionalities vest in the holder of the security instrument. As a result, the

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236 Dendy "Agency" in *LAWSA* § 133, see also § 126, n 1.

237 Dendy "Agency" in *LAWSA* § 130, see also § 126 & n 2.

issuer need only perform towards the instrument-holder, for instance by paying this holder dividends, coupon-payments (interest and capital on debt securities), the allocated residual portion of assets after liquidation, or benefits due in terms of holdership of an ICIS. The issuer also need only, subject to limited exceptions, recognise the instrument-holder as empowered to exercise other competencies such as voting rights,[238] appraisal rights in terms of s 164 of the Companies Act, or redemption and conversion rights. Furthermore, only the instrument-holder has the requisite *locus standi* to compel the issuer to do so, because the instrument-holder is the sole holder of the entitlement of determination (*opvorderingsbevoegdheid*) over the totality of the underlying interest, allowing this holder to establish a valid cause of action. However, it remains that only the asset-holder (as beneficial interest holder) is entitled to the ultimate (economic) benefits of these rights and competencies as patrimony.

This manner of construing the nature and structure of the registered "ownership" allows one to make much more sense of the current legal position, as well articulated in *Commentary 2008*:[239]

> "Generally, upon the entry of a person's name in the securities register, the person becomes entitled to the rights of a registered holder (referred to in these notes as 'registered title' for convenience, without suggesting that the holder is the legal owner in the same manner as applies under English law) in respect of the securities in question…Also, the acquisition and termination of registered title need not correspond with the acquisition or disposal of beneficial ownership (or another beneficial interest) in any securities.
>
> Under English law, registered title constitutes legal ownership at law, notwithstanding that under equity law the beneficial ownership can vest with another person based on the application of English law of trust (actual or constructive). While South African company and trust law is based on English law, the preferred view is that South Africa has not generally adopted the English concept of dual ownership in regard to property and has rejected the concept of constructive trusts. Consequently, the relationship between a beneficial owner (without registered title) and its nominee (with registered title) is regarded as a relationship of principal and agent (in contrast to a trust relationship under English law). *Nevertheless, our courts are influenced by English jurisprudence and sometimes strive to achieve a functionally similar result.* Based on this, traditionally a company has been regarded as confined to its securities register and the nominee is generally regarded as having the exclusive rights to enforce the rights attaching to a share. This gives rise to some uncertainty as to the exact position of a nominee, in particular whether a nominee is vested with any proprietary rights. While the agency construction suggests that the nominee is bound by the memorandum of incorporation in its capacity as agent, the nominee is nevertheless usually regarded as holding the securities *as if it were the owner* (i.e. as principal) in relation to the company because the company is regarded as confined to its register and the nominee is generally responsible for the

238 With the *prima facie* exception of the provisions of s 56(9)-(11).

239 Yeats et al *Commentary 2008* 2-665 – 2-667.

shareholders' obligations and entitled to enforce the shareholders' rights against the company in its own name to the exclusion of the beneficial owner."

With this in mind, consider first the legal position of this agent and the source of the agent's *authority* – i.e. the legal basis for execution of the security. It is trite that an agent's capacity to conclude juristic acts on behalf of the principal must derive from authority. Although the source of such authority is typically the juristic act of authorisation, there are a number of other ways in which such authority can be brought about, including "by operation of law".[240] Here one must remember that the constitutive source of a security's underlying interest has continued relevance throughout the operative lifetime of a security because it is binding upon each successive acquirer, so that any structural modifications that source imposes on the underlying interest are intrinsic to each security.[241] The key structural property in this particular context is the dual nature of securities, and the *content* of the dual components – i.e. the instrument- and asset-holdership respectively.

In that structure is an implicit and unavoidable legal nexus between the instrument-holder and the asset-holder: the contents of holdership of both derive from the *same* complex of rights and competencies forming the underlying interest. Quite simply, the "legal machinery by means of which legal relationships can be created, altered or extinguished between…[a legal subject] and a third person via the representative" (a formulation ascribed to JC de Wet),[242] is already in place, and need not be actively created by the principal. Each holder is merely a different *kind of creditor* with reference to the common underlying right or rights.[243]

On this basis, it is submitted that the authority facilitating the agency between instrument- and asset-holder arises *by operation of law*, as a result of the underlying (dual) structure of securities operating vis-à-vis security-issuers. In the case of securities issued by entities other than companies, the authority is purely a function of the acquiring contract, as given effect to by issue of the security. In the case of companies' contractual securities, it is a function of the terms of the acquiring contract, the memorandum, as well as supplementary provisions in the Companies Act, as given effect to by issue of the security. In the case of shares, it is a function of the empowering legislative matrix put

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240 See AJ Kerr *The Law of Agency* 3 ed (1991) 8; and Dendy "Agency" in *LAWSA* § 125 & § 138, the latter also containing examples such as directors' authority derived from the memorandum of incorporation of a company, or state officials' authority deriving from empowering legislation.

241 See § 4 1 1 above.

242 This is from a passage in the second edition of *LAWSA* on agency, which in turn was ostensibly adopted from the first edition with minimal – if any – modifications from the first edition written by JC de Wet – see Dendy "Agency" in *LAWSA* § 139. In this paragraph, Dendy makes much of the debate between Kerr, and de Wet and his successors to the *LAWSA* "Agency" publication as to the nature of the authorising act. Obviously, this is not directly relevant here as an authority by operation of law is posited.

243 See Lubbe (1989) *THRHR* 498 – "*[d]ie oënskynlike teenspraak in die erkenning van beide die geregistreerde aandeelhouer en die genottrekker as skuldeisers van die maatskappy word uit die weg geruim indien ingesien word* dat albei skuldeisers is, maar dan met betrekking tot afsonderlike komponente van die volle skuldeisersbelang." [own emphasis]

in place by the Companies Act, in conjunction with the company's memorandum, to govern the legal dynamics of shares.

However, one could argue instead that the primary market acquirer, and all subsequent secondary market acquirers, of a particular security authorise – by implicit juristic act – the instrument-holder simply by accepting the security asset. To do this, one interprets acceptance of the beneficial interest without registered holdership as also constituting the unilateral juristic act required to empower the nominee. This is artificial and convoluted.

Moreover, there is case law which appears to be demonstrably in line with the first view, running contrary to this view. These cases pertain to the legal position between the acquirer and disposer (or the disposer's nominee) of a certificated security[244] after cession of the beneficial interest has taken place, but before registered transfer. What makes the scenarios in these cases crucially important is that in each there is *no explicit arrangement* between the (new) asset-holder and the instrument-holder. What these cases appear to establish is that the law is unable to accommodate a situation where the asset-holder does not have control over the instrument-holder, and is seemingly willing to read in an implied authority in the absence of express provision for it.

Moosa v Lalloo,[245] *Standard Bank of SA Ltd v Ocean Commodities Inc,*[246] and *Gomes-Sebastiao v Quarry Cats (Pty) Ltd*[247] all confirm unequivocally that:[248]

> "a seller, prior to [registered] transfer of a share to the purchaser, is in fact a trustee on behalf of such purchaser. As trustee, the transferor is bound to act upon the instructions of the transferee."

The English doctrine of constructive trust – intimately tied to legal and equitable ownership – is not a feature of South African law,[249] and for this reason Blackman et al describe this reference to "trust" as a:[250]

> "*sui generis* implied agency…(and has similarities to a deposit arrangement)…"

244 Unsurprisingly, the cases deal with shares, but the principle is equally applicable to all securities.

245 1956 (2) SA 237 (D) 238-239.

246 1980 (2) SA 175 (T) 181-182.

247 [2010] JOL 26416 (GSJ).

248 *Gomes-Sebastiao v Quarry Cats (Pty) Ltd* [2010] JOL 26416 (GSJ) [39].

249 *Lucas' Trustee v Ismail and Amod* 1905 TS 239 244; Blackman et al *Commentary* 5-172 n 6; and T Honoré & E Cameron *Honoré's South African Law of Trusts* 4 ed (1992) 17 & n 132.

250 Blackman et al *Commentary* 5-172 n 8.

One can now posit more correctly that it is implied not by a juristic act, but rather by the structural features of securities. Furthermore its "*sui generis*" nature is now made clear.[251] The instrument-holder will always be regarded as the agent of the asset-holder, and thus is guaranteed authority by virtue of the nature and contents of instrument-holdership *as it stands in relationship to the nature and contents of asset-holdership*. The law will, indeed must, always ascribe authority to the instrument-holder as agent of the asset-holder. Thus, this holder will, as a point of departure, *always* have the requisite authority to deal with the issuer vis-à-vis the security in question. This deals with the control over the execution of securities.

What has not been dealt with is the implications thereof for the direct relationship between agent and principal – i.e. "control over the executor".

In this regard, case law further dictates that a second default facet of this agency is the obligation to adhere to the directives of the asset-holder. As cited with approval in *Ocean Commodities Inc v Standard Bank of SA Ltd,*[252] the "concept of a nominee" is described in *Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd*, as follows:[253]

> "A nominee is an agent with limited authority: he holds shares in name only. He does this on behalf of his nominator or principal, *from whom he takes his instructions*; see *Sammel and Others v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A) at 666."

The notion that the agent's authority is *inherently limited* by an imperative to adhere to the instructions of the asset-holder is also echoed in *Standard Bank of SA Ltd v Ocean Commodities Inc,*[254] *Dadbhay v Dadbhay,*[255] *Francis v Sharp*[256] and *Gomes-Sebastiao v Quarry Cats (Pty) Ltd.*[257] This is a converse, but equally de facto, outflow of the structural properties of securities, and is almost self-evident from a legal policy perspective.

In this regard, Blackman et al further state that the instrument-holder as agent "*binds himself* to exercise his rights and powers…*as directed by, and in the interests of* the beneficial owner",[258] and

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251 With the utmost respect to Blackman: simply stating, without more, that something is *sui generis* has been, accurately, described by AJ van der Walt as "the ultimate theoretical cop-out" – Van der Walt (1990) *THRHR* 322.

252 1978 (2) SA 367 (W) 370G.

253 1976 (1) SA 441 (A) 453A [own emphasis].

254 1980 (2) SA 175 (T) 182.

255 1981 (3) SA 1039 (A) 1047.

256 2004 (3) SA 230 (C) 238.

257 [2010] JOL 26416 (GSJ) [39].

258 Blackman et al *Commentary* 5-171.

look to U.S. authorities[259] to underscore the *fiduciary* nature of the nominee-agent's relationship to the beneficial interest-holder.[260] However, in light of the above, a better formulation may be that the instrument-holder is "is automatically bound…", as no voluntary juristic act is required for this bond to arise.

Furthermore, the dual premise that the instrument-holder has proximate control over the execution of the underlying interest of the security, but the asset-holder remains solely entitled to all patrimonial benefits of that interest yields a further insight. Simply: the instrument-holder *exercises control over the patrimony of another*, just as a director exercises control over the patrimony of the shareholders; a trustee over the patrimony of its beneficiaries; a depositor over the patrimony of a depositary; or a *gestor* over the patrimony of the *dominus negotii*.

These very similar examples serve to highlight that from a policy perspective there appears to be a clear fiduciary imperative arising from this arrangement. This is why Blackman et al describe this agency as similar to depositary arrangements, and more importantly why the courts have persisted in using the term "trust" and "trustee" despite it being inappropriate in the literal and strict sense[261] – it conveys something of this fiduciary dimension which the courts are, justifiably, reluctant to omit from the formulation.[262] Importantly, this also strengthens the critical distinction between the right of the asset-holder to have instrument-holdership *transferred to her* (which she holds) and the *right to registered title* (which she may or may not hold, depending on the set of facts, and directives, between the two holders).[263]

In sum, from the underlying structure of securities, the following becomes clear.

First, a mere instrument-holder (i.e. a nominee) derives the capacity to act as representative agent on behalf of the asset-holder (as principal) by operation of law, due the manner of separation of the incident-functionalities of the underlying interest into asset and instrument.

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259 *Application of Stephen J Saft and others, Executors of the Estate of Thomas Elmezzi, Deceased,* 24 Misc. 3d 1214 (A), 897 NYS. 2d, 672 – and numerous U.S. authorities cited in the quoted portion of the judgement by JB Jordan, J.

260 Blackman et al *Commentary* 5-171-172 in n 5. This is echoed in Yeats et al *Commentary 2008* 2-570 – 2-571:

> "Based on the traditional position, generally the rights attaching to the securities must be exercised by the registered holder and therefore by the nominee, and not the beneficial owner. Because the relationship between the beneficial owner and the nominee is based on agency, the nominee is usually bound to exercise his rights and powers as a registered holder of the securities in accordance with the directions, and in the interests of, the beneficial owner, and to deliver up to the beneficial owner any benefits obtained in respect of the securities."

261 See the dicta of Innes, J in *McCullogh v Fernwood Estates Ltd* 1920 AD 204 209.

262 See also Honoré & Cameron *Trusts* 2 & n 4, and 3.

263 See specifically Yeats et al *Commentary 2008* 2-675.

Second, the extent, scope and content of the authority bestowed upon the instrument-holder as agent is, for that same reason, inherently limited by: (1) the asset-holder's directives, and (2) the implicitly fiduciary nature of the relationship.

Third, perhaps most strikingly, it greatly simplifies legal analysis related to these relationships. By postulating registered rights as a separate type of *holdership* of a *different legal object*, it elevates the so-called perspective of the issuer – i.e. the position in terms of internal relations – to a feature of the objective law, undoing the need for separate legal analyses. It reveals that there is, by virtue of instrument-holdership, automatic authority (balanced by limited scope and a fiduciary nature) to deal with the issuer, and to do so to the exclusion of the principal. In so doing, it creates a picture of these tripartite relationships where the ostensible difference between "internal" and "external" positions is resolved. This allows for single integrated legal position and consistent application of principles instead of the anomalous effects of received English company law (and ultimately trust) jurisprudence within a Civilian private law. It unifies potentially divergent legal outcomes regarding issues such as rectification, remedial litigation, authority and control of the agent, and the position of the beneficial interest holder.

It also abrogates the need to posit some entirely separate registered "ownership standing" independent of "beneficial ownership" where the former must also (by virtue of the view's inherent inconsistencies) be described as simultaneously resembling *quasi-possessio and* a proprietary interest.

However, although the exclusivity between instrument-holder and issuer is inviolable, this must not be taken to mean that its default form – between asset- and instrument-holder *inter se* – is not *alterable*. The only hard limitation is that alteration cannot have any bearing on the legal position of the issuer. In *Francis v Sharp*, the court specifically states:[264]

> "If, as alleged, the plaintiff was the beneficial owner of shares in the company, the first and second defendants, as her nominees, were bound to exercise their rights and powers as members as directed by, and in the interest of the plaintiff as beneficial owner (*Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty)…*). The nature of the rights and obligations of the plaintiff as nominator and the first and second defendants as nominees *inter se* would be governed by the contract or relationship between them (*Henochsberg on the Companies Act* 5th ed vol I at 210)."

Thus, despite the fact that there is already a fully formed legal relationship between the asset- and instrument-holder as described above, the parties may choose to augment, supplement or even

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264 2004 (3) SA 230 (C) 238; this is also cited with approval in Blackman et al *Commentary* 5-171 n 5.

change its nature. This can be achieved by altering the scheme of authority (unilateral or bilateral[265] alteration of the above de facto scheme of agency), or through the conclusion of a superordinate contract of mandate, or even through the use of a trust or *bewind* trust. The relationship of trust in the less formal sense – i.e. a fiduciary relationship – may also be made more formal and detailed by agreement.

If a contract of mandate is concluded, one could still use the term agency, but in the wider sense, "in terms of which one person, called the agent, performs some task for another person, called the principal, in connection with a juristic act by *or* for the principal…[which] belongs to the category of contracts known as mandate or *mandatum* in Roman-Dutch law". This typically includes a scheme of "agency as representation" but goes beyond it.[266] The law regarding mandate is fairly settled, and it is unnecessary to go further than this here.[267]

The relationship between asset- and instrument-holder may also be altered as a consequence of the intercession of a formal trust.[268] In these cases, one must further distinguish between an ordinary trust and a *bewind* trust.[269]

Regarding the former, the trustee is the asset-holder *nomine officii*,[270] and can either make use of a nominee as instrument-holder and thus agent, or simply also take the position of instrument-holder herself. Such a trustee must manage the security for the benefit of the trust beneficiary, but the latter has no direct interest in the security – merely a personal right against the trustee to the benefits of the security as a trust asset.[271] Thus it contributes nothing to the discussion, as either the default legal position (as above) exists between holders, or there is no separated, dual-holdership to begin with.

The case of a *bewind* trust is more complicated, as the security asset resides in the estate of the trust beneficiary, but control over that asset with the trustee.[272] Such control can be brought about in two ways. The first is where the trustee is made the instrument-holder, controlling the security through the incidents of execution for the benefit of the beneficiary. This leaves the default position

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265 See M Dendy "Agency" in *Law of South Africa* Vol 1 (3 ed) 2014 § 138 for a full discussion of the debate regarding whether agency may be conferred unilaterally, which seems correct as a point of departure.

266 M Dendy "Agency" in *Law of South Africa* Vol 1 (3 ed) 2014 § 125 & n 1-2.

267 M Dendy "Agency" in *Law of South Africa* Vol 1 (3 ed) 2014 § 125, and see also *Totalisator Agency Board, OFS v Livanos* 1987 (3) SA 283 (W) 291 294.

268 Honoré & Cameron *Trusts* 3.

269 See specifically Honoré & Cameron *Trusts* 4 paras. (ii) & (iii) and 5 for the distinguishing issue of ownership in this regard.

270 See *Thorne & Molenaar NNO v Receiver of Revenue, Cape Town* 1976 (2) SA 50 (C) 52.

271 Honoré & Cameron *Trusts* § 349, 473-474 & n 45.

272 Honoré & Cameron *Trusts* 4-5.

as discussed above unchanged in principle, but an additional layer of trust rules is imposed on the legal relationship.

The second manner of effecting the necessary control for a *bewind* trust is where the trustee makes use of a nominee. Here, the nominee (as instrument-holder) holds the ability to execute the security's underlying interest, but ultimate control over the instrument-holder is exercised through the trust vehicle by the trustee, despite the fact that the trust *beneficiary* is the asset-holder. This may seem a peculiar situation, as it is the one instance where *no* ultimate control over instrument-holder resides with the asset-holder. However, this is a result of the principles and operation of trust law as overlaid upon the holdership arrangements, having little effect on the applicable securities law principles outlined here.

Thus, with the exception of the *bewind* trust, the asset-holder will always retain an *original* authority to issue directives and instruction to the instrument-holder. Any interceding intermediation between these parties manifests, legally, as a *delegation* of this power to the relevant intermediary or successive intermediaries.

In the case of the *bewind* trust, on the other hand, the scheme of directives (which both directs and limits the instrument-holder's authority) flows from the *trustee* rather than the beneficiary-and-asset-holder, as part of what could be characterised as a delegation effected through the principles of trust law. All that appears to be required is that the asset-holder or someone appointed on the holder's behalf (such as a trustee of a *bewind* trust or when a broker is made use of) *must be in a position to exercise ultimate control over the executor* of the underlying interest (the instrument-holder), doing so through the scheme of directives which inherently limits the agent's authority.

4 3 2 The proprietary features of securities

It is axiomatic that registered securities are incorporeal property. However, in this context "property" is not necessarily a precise, nor helpful term. First:[273]

> "[t]he use of the word "property" in law is complicated by a variety of factors…Hence, the exact meaning of this complex term depends almost entirely on the context in which it is used. Even on the most elementary level, this term signifies various different but distinct legal concepts. First, it may signify the right of ownership in a legal object. Second, it may also refer to the legal object (or "thing") to which this right relates. Since the introduction of a new constitutional order…the term "property" may, in the third place, denote a variety of legal relationships qualifying for protection as such under the Constitution, although they

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273 Badenhorst et al *Law of Property* 1.

> might not resort under either of the two previously mentioned descriptions. Thus "property" is not a term of art and in itself no more than a convenient expression to denote the existence of some types of legal relationships between specific persons and legal objects, which in many instances can be classified as "things".

Second, the imprecise scope of the term is exacerbated by issues regarding the meaning of "rights", such that property:[274]

> "in the sense of "rights" is traditionally seen as ownership or real rights, but may also be perceived in a wider sense, so as to include patrimonial rights, such as personal rights and immaterial property rights."

Nonetheless:[275]

> "While it may be doubtful whether the rights which a share confers on its holder can be classified as 'property' in the usual sense, one thing at least is clear: the share itself is an object of dominion, i.e., of rights in rem and not so to regard it would be barren and academic in [the] extreme. For all practical purposes shares are recognised in law, as well in fact, as objects of property which can be bought, sold, mortgaged and bequeathed. They are indeed the typical items of property of the modern commercial era and particularly suited to its demands because of their exceptional liquidity. To deny that they are 'owned' would be as unreal as to deny, on the basis of feudal theory, that land is owned…"

The problem of using the terms "ownership", "property" and "proprietary" without a firm theoretical foundation of what this denotes is also aptly illustrated by the authors in *Commentary 2008* in their description of "registered ownership" of a security as an independent "proprietary", or "quasi-proprietary" ownership interest that also has elements of *quasi-possessio*.[276]

However, there is analytical usefulness to the term property in the context of (incorporeal) securities. Most notably, this usefulness lies in "property" as: (1) a denotation of the *patrimonial* characteristic of securities as potentially valuable assets, and (2) indicative that certain limited real rights may be established over one or more of the incidents of securities, very similar to the manner in which limited real rights can be established over corporeal property.[277] It follows that the *proprietary aspects* of holdership are in fact quite important, especially in terms of laying a theoretical groundwork for the more practical problem-solving exercise of Part 2 of this work.

The first question in coming to grips with the proprietary dimension of securities is whether securities ought to be viewed as (incorporeal) *things*. This can be easily answered with a comparison between

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[274] Badenhorst et al *Law of Property* 19.

[275] LCB Gower, JB Cronin, AJ Easson & B Wedderburn *Gower's Principles of Modern Company Law* 4 ed (1979) 400.

[276] See for example Yeats et al *Commentary 2008* 2-669 – 2-670, and the passages discussed above in § 4 1 3.

[277] As argued in § 4 1 1 and what follows in this section below, respectively.

the qualities (or required characteristics) ascribed to things and the demonstrable qualities of securities. Both securities and things are: impersonal, independent, susceptible to human control, and have a great deal of use and value.[278] Thus the issue comes down to *corporeality* as the final ostensibly required characteristic of all things,[279] a quality that securities do not possess. Is this requirement unavoidable, or can (perhaps rather should) securities nonetheless qualify as things?

The currently prevalent legal view, principally influenced by the modern paradigm of subjective rights, is that (but for a number of what have been styled doctrinal "exceptions") incorporeal rights, such as personal rights or limited real rights, are not things. This is despite their recognition in the Roman and Roman-Dutch, essentially Gaian, property systems as *res incorporales.*[280] The main reasons advanced[281] for their exclusion from the typology are that it (1) would require the recognition of a "right to a right", which has been deemed a jurisprudential absurdity (which argument is, itself, absurd);[282] (2) would dissolve the distinction between real and personal rights to an unacceptable degree;[283] (3) obviates the principle that real rights require corporeal things as objects because real rights confer direct *physical* control over their objects;[284] and (4) it subverts, or ignores, the fundamental distinction between the legal object of a subjective right and the subjective right itself.[285] For various complex and technical reasons these arguments are unconvincing, but need not be further challenged here.

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278 CG Van der Merwe *Sakereg* 2 ed (1989) 23-27; Badenhorst et al *Law of Property* 22-30; and Van der Walt & Pienaar *Property* 13-15.

279 Van der Merwe *Sakereg* 24-25; Badenhorst et al *Law of Property* 21-27; and Van der Walt & Pienaar *Property* 1-14.

280 See authorities cited above as well as Kleyn (1993) *De Jure* 3-7; and generally Gretton (2007) *RabelZ Bd.* 802 *et seq* and Gretton (1997) *Stell LR* 176 *et seq.*

281 See Kleyn (1993) *De Jure* 8-10; Van der Merwe *Sakereg* 21-23; and Badenhorst *Law of Property* 23.

282 This particular argument has many times over been shown to be incorrect and contrary to the juridical reality – see particularly Kleyn (1993) *De Jure* § 3, 5-6 and authorities cited therein; Van der Merwe *Sakereg* 22; and Badenhorst et al *Law of Property* § 2.3, 21.

283 Despite that, alternative approaches (most notably the "subtraction from the *dominium*" test) are demonstrably functional methodologies which do not derive their classificatory effectiveness from determining the nature of the legal object in question.

284 Although the underlying reason for the need to ascribe a physicality to a relationship of control is not clear.

285 Nonetheless, related to the first reason, rights are able to form the object of rights. Here is another clear example of why the doctrine of subjective rights is inadequate, or at least incomplete, as a free-standing theory of horizontal private law relationships.

Despite this seemingly strict exclusion the law has extended, in a number of instances, certain legal concepts (*regsfigure*) traditionally applicable only to things, to incorporeals – treating rights, and indeed *incidents* of rights,[286] as legal *objects*. From a policy perspective:[287]

> "*[d]ie een waarheid wat die hele lange geskiedenis sowel as die Suid-Afrikaanse regspraktyk in hierdie verband leer, is die feit dat daar reeds van die vroegste tye af 'n wesenlike behoefte in die praktyk bestaan het na die* onstoflike as kommoditeit binne die sakereg*, of dan in moderne terminolgie,* die funksionering van regte as objekte in die saaklike reg. Die rede hiervoor is te vinde in die ekonomiese waarde wat in hierdie regte opgesluit is. Trouens, daar word beweer dat rykdom vandag hoofsaaklik uit vorderinge met kommersiële waarde bestaan *en dat die* res mancipi *van vandag onstoflik is.*"

This point rings especially true in the case of securities. In the modern economy they serve crucially important commercial functions for issuers, most notably the functions of capital-raising and conversion of fruit-bearing assets into liquid capital (i.e. securitisation). This is equally true for holders – typically securities fulfil an investment-function as a store *and* creator of wealth, and a less-mentioned but systemically critical collateral function by serving as real security for the incurrence of (mostly commercial) debt.[288]

With regard to these exceptional cases of extension (typically through limited real rights over incorporeals), a subtle distinction in the nature of the originating rights should be pointed out. Certain secondary incorporeal rights are "corporeal-adjacent" in the sense that they pertain directly or indirectly to the control of things in the true sense. These rights are mostly, but not always, real rights. This accounts for most of the well-established instances of extension, such as the courts' recognition of a pledge over mineral rights,[289] as well as provisions in the Deeds Registries Act[290] allowing for real security rights over real rights to land, personal servitudes, and, again, mineral rights. Yet certain personal rights, such as those of a lessee, also exhibit an adjacency to an underlying corporeal thing. This is evidenced, for example, by the Deeds Registries Act's recognition of real security rights over leases and mineral leases.

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286 It has been established, as a prime example of an *incident* serving as object of another right, that usufructary rights may themselves be pledged – see Van der Merwe *Sakereg* 514 & n 416; Badenhorst et al *Law of Property* 315 & n 155; as well as Roman-Dutch authorities including *D* 20 1 11 2; Voet 7 1 32; and Van der Kessel *Praelectiones ad Gr* 2 39 5.

287 Kleyn (1993) *De Jure* 7 [own emphasis].

288 See Benjamin *Interests in Securities* 5-8.

289 *Ex Parte Eloff* 1953 (1) SA 617 (T); PJ Badenhorst "Vruggebruik ten aansien van ontginningsregte" (1993) *Stellenbosch Law Review* 394; Kleyn (1993) *De Jure* 5; and Badenhorst et al *Law of Property* 24.

290 47 of 1937.

This adjacency is alluded to by a number of authoritative sources[291] in the context of the spoliation order. Specifically, this quality is important in determining whether a finding of *quasi*-spoliation of an incorporeal right, as a factual state of affairs, is tenable. Quasi-spoliation seems to require some nexus, or at least similarity, to true possessory control over a corporeal thing.[292] Hence:[293]

> "[i]n cases of so-called quasi[-]possession where the mandament has been used in the past, the exercise of a right was always *so closely connected with possession of corporeal property* that loss of the right could be regarded as an infringement of possession of the corporeal object itself."

However, not all incorporeal rights exhibit such corporeal-adjacency. Securities, inter alia, fall into this latter category, and have no sufficiently close connection to (control over) any corporeal legal object (as will become clear throughout the rest of this Chapter, the use of physical certificates is not enough for this not to be true). The same can be said of a great many personal rights and, perhaps as a rule, of intellectual property rights.

This extension of legal concepts found in the law of things has also been applied to incorporeals that have no connection to corporeal things. Most notable is the pledge construction of the cession *in securitatem debiti*. Other examples include the extension of the *usufruct* construct to shares,[294] and perhaps even entire estates,[295] as well as the *quasi-usufruct* to, inter alia, debts.[296] There has also been, whether correctly or incorrectly,[297] an extension (in principle only) of the mandament van spolie (and by implication some form of *quasi-possessio*) to securities register entry.[298] The protection of holdership of securities is more specifically dealt with in Chapter 11 and to some degree also Chapter 10. However, neither this topic nor other elements of the broader theme at hand can be satisfactorily accounted for without a coherent theoretical understanding of the proprietary features, and specifically the factual features, of the various forms of holdership of securities.

Moreover, there are some limited references to incorporeals as things in the literature. It has for instance been stated that "South African legal practice has recognised the existence of incorporeal *things* and real rights relating to them, therefore confirming the notion of a right being the object of

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291 For instance Van der Walt & Sutherland (2003) *SA Merc LJ* 95 § 1, 96 & § 7, 108; and Badenhorst et al *Law of Property* 275, with numerous authorities cited in n 93 therein.

292 Van der Walt & Pienaar *Property* 203-206 as well as the cases cited therein.

293 Van der Walt & Sutherland (2003) *SA Merc LJ* 95 § 1, 96 [own emphasis].

294 *Cooper v Boyes* 1994 (4) SA 521 (C).

295 Van der Merwe *Sakereg* 509; and AFS Maasdorp *Institutes of South African Law: The Law of Property* 10 ed (1976) 188.

296 See *Cooper v Boyes* 1994 (4) SA 521 (C) in this regard as well.

297 See Van der Walt & Sutherland (2003) *SA Merc LJ* 95 *et seq.* This will be addressed in Chapter 11.

298 *Tigon Ltd v Bestyet Investments (Pty) Ltd* 2001 (4) SA 634 (N).

another right."[299] Whilst the latter part of the statement is undoubtedly correct, the former is doctrinally contentious. It relies on *Janse van Rensburg v Grieve Trust CC*, where the court made the following observations:[300]

> "On the facts appearing from the stated case, it is clear that the parties entered into a single contract of purchase and sale, the traded-in vehicle ostensibly forming part of the purchase price of the vehicle purchased in terms of such contract. In fact it was not the vehicle as such which was traded in, but the purchaser's incorporeal right thereto in terms of his credit agreement with a third party. It is common cause that the appellant, as purchaser, made an innocent misrepresentation relating to the model of the traded-in vehicle. On the strength of such misrepresentation, the respondent, as seller, agreed to place a higher valuation on such vehicle than was warranted by its actual model.
>
> *In view of the legal considerations set forth above, it is irrelevant whether the contract of purchase and sale relates to a corporeal or incorporeal thing*. It is likewise of no moment that the said thing does not contain a latent defect or defects, but has merely been misrepresented (by way of a *dictum* or *promissum*) as being something which it is not. In all these cases the *aedilitian* actions are available. Most importantly, for present purposes, is the fact that it does not matter that the defective or misrepresented thing is not the object of a sale or barter. The *aedilitian* actions are equally applicable to an object forming part of the purchase price or *pretium* of a thing purchased. Hence, on the grounds set forth above, the *actio quanti minoris* is available to a seller in a trade-in agreement should the vehicle traded in be defective or misrepresented as aforesaid."

In order to justify the availability of the *actio quanti minoris*, the court appears to have extended the notion of things to include incorporeals. Specifically, the right *in casu* is the seller's *personal right* operative against the (third) party with whom a credit agreement was concluded (in order to finance the vehicle). In such cases, the patrimonial value of the *claim* against the financing party (as owner) for delivery of the vehicle upon full repayment will approximate the value of the vehicle less the value of the outstanding instalments. If the model of the vehicle is misstated, the value of the claim will have been misrepresented, as was held. This would appear to apply equally to sales transactions in which the value of a share or a debt security has been misrepresented.

Yet to take this as the recognition of incorporeal *things* within the South African property dispensation ("the purchaser's personal right to the traded in vehicle…was recognised in *Janse*…as an incorporeal thing for the purposes of a contract of sale")[301] is, respectfully, a misreading of the case. The contractual construct of sale is not limited to things, as any patrimonial object can, in principle, be made subject to a purchase or sale. Logically, therefore, the *actio* as a remedy of *sale* applies equally to any patrimonial object capable of transfer, and there is no need to elevate personal rights

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299 Badenhorst et al *Law of Property* 23 & n 60-61 [own emphasis] – an uncharacteristic misstatement in an otherwise eminently useful student handbook.

300 [1999] 3 All SA 597 (C) 608.

301 Badenhorst et al *Law of Property* 23 n 60.

to the status of things before the action becomes available. The use of the phrase "corporeal or incorporeal thing" should be seen as mere terminological inaccuracy, where "*merx*" would have been more suitable.[302]

Further, AJ Van der Walt and GJ Pretorius in *Introduction to the Law of Property* also appear to suggest that an important exception to the corporeality requirement is the case of shares, citing *Ben-Tovim v Ben-Tovim*[303] as "[providing] that shares in a company…are incorporeal *things*."[304] Yet, again with respect, (1) a reading of the case reveals the court merely stated that shares are "property" and nothing more;[305] (2) it does not follow that an incorporeal is a thing merely because it functions as the patrimonial object to another right, as per the *usufruct* example given in-text; and (3) this is in any event not in line with the predominant view.

These rare statements do not make *things* of these incorporeals, and it is submitted that incorporeals should not, for the sake of legal clarity, accuracy and most importantly rigour, be regarded as things, despite certain merit-worthy theoretical assertions to the contrary.

In fact, this position reveals a more important and fundamental source of theoretical friction. Despite the fact that the South African private law (including the law of things) is, at least as point of departure, ordered in accordance with the doctrine of subjective rights, its common law is not.

First, to make this argument, a more accurate view of the nature of the South African common law must be articulated. It is submitted that to state that the South African common law is the Roman-Dutch jurisprudence of Holland during the 16th and 17th century[306] is a misstatement. In truth, after the dust of modernist-purist debate settled during the mid- to late-20th century, it became clear that South Africa has a common law system: (1) that relies on Roman-Dutch authority stretching not only beyond the borders of Holland (strong reliance on Von Savigny, for example, can be offered up as

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302 However, in AJ Kerr & G Glover "Sale" in WA Joubert (ed) *Law of South Africa* Vol 24 (2 ed) § 2 the same error is evident – stating that the "*[t]hing* to be sold may be movable or immovable, corporeal or incorporeal" [own emphasis].

This is, again, a terminological inaccuracy and in all likelihood a result, or at least more evidence, of the historical legal friction outlined below.

303 2001 (3) SA 1074 (C).

304 AJ Van der Walt & GJ Pretorius *Property* 14 [own emphasis].

305 *Ben-Tovim v Ben-Tovim* 2001 (3) SA 1074 (C) 1088.

306 See *Tjollo Ateljees (Eins) Bpk v Small* 1949 (1) SA (A) 865 for the narrowest statement on this issue.

evidence of this), but also beyond the 16th and 17th century; and (2) wherein a marked English law influence is not only evident, but indeed actively *present*.[307]

Moreover, largely due to the operation of the (English) principle of *stare decisis* in South Africa, the most robust description of the South African common law of today is one framed in terms of case law. It appears to be more sound and accurate to state that the common law comprises of those English law principles *received through case law*, operating in conjunction with those Roman-Dutch (in the wider sense) principles which have been *revived through case law.*

The total, wider omnibus of English and Roman-Dutch law principles should not be seen as an active or concrete part of the South African law in so far as it is not reflected in modern case law. Instead these principles have a *latent* function, to be relied upon only when the positive law falls short, and requires development not evident in *existing case law.*[308] Even then, these principles are often modified to suit the contours and unique development of modern South African law, rather than received verbatim. To use simple terms, the totality of these respective systems' principles stand with only one foot in, and one foot out, of the South African positive law.

This is a source of theoretical friction because when the South African courts turn to the Roman-Dutch elements of the common law to solve unprecedented contemporary legal problems,[309] they turn to a system of private law which *pre-dates* the doctrine of subjective rights. The courts' recognition, for instance, of the pledge or *usufruct* over incorporeal rights is perfectly acceptable in the older, essentially Gaian division of things (including *corporales* and *incorporales*) from which the courts formulate their point of departure. However, this does not so easily accord with the modern order of private law constructs flowing from the doctrine of subjective rights. A clear illustration of this issue is the circumscription of the *merx* in the contract of sale as inclusive of incorporeal things as discussed above.

With this as background the focus can turn to securities. The theoretical framework developed in the first section of this chapter is partially derived from a theoretical position which arose *specifically to rationalise* one these common law-driven exceptions, namely the pledge construction of the cession

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307 See Du Plessis *Introduction* 1999 49-70; D Klein & F Viljoen *Beginners Guide for Law Students* 3 ed (2002) 19-41 & 82-87; PJ Thomas, CG Van der Merwe & BC Stoop *Historiese Grondslae van die Suid-Afrikaanse Privaatreg* (2000) 17-120; as well as both R Zimmerman & D Visser "Introduction: South African Law as a Mixed Legal System" and E Fagan "Roman-Dutch Law in its South African Historical Context" in R Zimmerman & D Visser (eds) *Southern Cross: Civil Law and Common Law in South Africa* (1996) 1 & 33 (specifically 41-45) respectively.

308 South African law, still today, places a guiding reliance on English law principles in disciplines where they are applicable – see for example R Stevens & PJ de Beer "The duty of care and skill, and reckless trading: remedies in flux?" (2016) 28(2) *South African Mercantile Law Journal* 250 for a holistic account of the influence of these principles in the sphere of directors' duties.

309 A practice which is so self-evident in its frequency throughout the body of South African case law that it needs no citing of authority or examples.

in securitatem debiti. As it was necessary to reconcile this cession with a more modern view of the structure of personal rights, so it must be done for securities. To do so, as is the case for most of this chapter, the chosen point of analytical incision is at the level of securities' resultant incident-functionalities. In this paradigm, any analysis driven by the doctrine of subjective rights is bound to fail in accounting for the proprietary features of modern securities.

The following false paradox best illustrates this point. It is trite that, in the law of things, a number of simultaneous legal relationships (ownership *and* various forms of lawful holdership) can exist between a given legal object and a number of legal subjects.[310] It is further also, by the logic of the law, impossible for more than one legal subject to be the *possessor*[311] of a legal object simultaneously – there can only be one possessor of an object at any given time. Further, in order to pledge a corporeal moveable, possession must typically be handed over to the pledgee through *traditio*, and such possession is a legal function of effective factual control coupled with the requisite *animus.*[312]

However, if one were to take a share or debt security as legal object, the instrument-holder *seems* to have factual control over the rights and competencies which underlie it, through holdership of the incidents of execution. Thus, for example, the instrument-holder would appear to have *quasi-possessio* of the security for the purposes of the mandament van spolie.[313]

On the other hand, it would appear that *for the purposes of pledge* it is in fact the asset-holder who has factual control[314] of the security, and consequently by analogy has *quasi-possessio* required for a security cession. Two simultaneous instances of possession of the same object are impossible in

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310 This is well illustrated in Van der Walt & Pienaar *Property* 168-169, where by example the authors identify, for a television set, the owner as a bank in terms of a credit agreement, a credit purchaser as holder of a first right of use, a lessee as holder of a secondary right of use, a thief as interim unlawful holder, and the police ("confiscating authority") as final lawful holder *and* possessor.

311 For convenience, "possession" (and derivative words such as "possessor") here will denote both possession *animus domino* and "holdership" with other acceptable forms of the *animus* requirement.

This is because there appear to be two competing views on the meaning and role of possession. See on the one hand Van der Walt (1988) *THRHR* 316; and Van der Walt & Pienaar *Property* 167-176, which both emphasise the primacy of *control* and posit that there is only "possession" in the presence of *animus domini*, and "holdership" for all other mental states. On the other is the more traditional common law view of possession as physical control coupled to a contextually variable *animus* contingent on the function of possession in question, best illustrated in Van der Merwe *Sakereg* 95-107, and found also in JD Van der Vyver "Die juridiese grondslag van besitsbeskerming" (1970) 33 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 231; ADJ van Rensburg & CG Van der Merwe "Die aard van besit en die *animus*-element daarvan" (1978) *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 113; GL Peiris "Possession and policy in a modern Civil law system" (1983) 16(3) *Comparative and International Law Journal of Southern Africa* 291; Badenhorst et al *Law of Property* 260 & 263-264; and well summarised in Van der Walt (1988) *THRHR* 276 283.

312 See for instance GF Lubbe (revised by TJ Scott) "Mortgage and Pledge" in WA Joubert (ed) *Law of South Africa* Vol 17(2) (2 ed) 2008 § 418, and also n 294 above.

313 As per *Tigon Ltd v Bestyet Investments (Pty) Ltd* 2001 (4) SA 634 (N).

314 Again, in the sense of having the ability to *allocate* the patrimony locked up in the particular security – see § 4 1 2 above.

the paradigm of the law of things – as a matter of logic and practicality no two persons can possess a tangible thing simultaneously. The paradox is, of course, false because possession and, most likely, *quasi-possessio*, are not appropriate constructs for incorporeal objects which are not corporeal-adjacent, as they bear no nexus to physical things.[315]

It is unnecessary to delve any further into a legal-philosophical exposition of the merits, shortcomings or any adjustment of the classificatory scheme of rights and property in South African law, nor to characterise securities as things.[316] The pledge of securities is unassailably possible. So too, by virtue of *Cooper v Boyes*,[317] is the granting of a *usufruct* over shares and by implication (debt security) perpetuities. The case also shows that a *quasi-usufruct* over ordinary debt securities (the underlying debt is "consumable" in the sense that its value diminishes with every coupon payment) is possible. By ascribing incidents of use and enjoyment to securities, this opens the door for other constructs, such as lease of securities (which, whether or not correctly described as lease, already appears to be a commercial phenomenon), as well.

This is clearly, as Kleyn explains, due to the "*wesenlike behoefte…na die onstoflike as kommoditeit binne die sakereg…[om rede] die ekonomiese waarde wat in hierdie regte opgesluit is.*"[318] The practice of vesting rights over other rights, or even merely over certain incidents of rights, is not an outflow of a characterisation of incorporeals as "things". Rather, it is feature of law that has developed: (1) due to the commercial need for incorporeals and their components to functions *as the objects of rights*; and (2) because the residual Roman-Dutch, essentially Gaian, source material facilitated such development in modern South African law. The mere fact that rights (and even incidents of rights) may function as legal objects of rights is ultimately sufficient in the current context.

Nonetheless, it remains true that "a mechanical application of the tenets of property law to shares in a company [as well as to other securities] can sometimes result in anomalous conclusions".[319] Of central import here are the decisions of *Oakland Nominees v Gelria Mining & Investment Co* and *Cooper v Boyes* and *Tigon v Bestyet Investments.*[320] The anomalous nature of the legal issues raised by these and similar decisions flows principally from the uncertainties regarding the proprietary features of bundles of personal rights (and other competencies). However, based on the

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315 See § 4 3 2 2 below for a full discussion of *quasi-possessio* and related factual consequences in relation to holdership of securities.

316 As is suggested, for example, by Klein in advocating for the (re-)incorporation of incorporeals into the law of things) – Kleyn (1993) *De Jure* 1.

317 1976 (1) SA 441 (A); 1994 (4) SA 521 (C); and 2001 (4) SA 634 (N) respectively.

318 Kleyn (1993) *De Jure 7.* See also Malan *Collective Securities Depositories* 194.

319 E Leos "Quasi-usufruct and shares: some possible approaches" (2006) 123 *South African Law Journal* 126 126.

320 1994 (4) SA 521 (C).

work preceding this section, it has become possible to show that securities' unique properties allow for a sound and rigorous explanation of their proprietary features.

The primary hurdle in formulating a coherent account of this proprietary dimension of these instruments is the lack of a viable and functional equivalent to possession of corporeals. This *factual* construct fulfils a number of key proprietary functions which are of great relevance to securities.[321] The "enhanced" proprietary dimension of securities, coupled with their unique underlying structure, renders the dynamics of holdership of securities difficult to explain using purely existing private law principles. This will become increasingly clear in the remainder of this Chapter. Such an analogue to the possessory concept will also serve to facilitate a (corollary) understanding of the legal mechanics of establishing limited real rights over securities and subsidiary elements of securities, as discussed in Chapter 9. Thus the remainder of this chapter is devoted to outlining an account of the factual features of holdership.

However, a preliminary issue must be addressed – there can be no holdership of any sort without a legal object to establish holdership over. Thus, before the factual features of holdership can be properly treated, an accurate delineation of a "legal object" in the present context is required. This is dealt with in the first section, after which the factual features of securities are given full attention.

4 3 2 1 Legal objects in the incorporeal paradigm

A pivotal concept throughout this chapter has been that each of the dual components of a security can be a separate legal object. From an understanding of this, the meaning of holdership and even instrument become almost self-evident.

A logical first question is whether the security asset and instrument, in the form posited in § 4 1 above, are capable of juridical objectification in the first place. However, as will be seen, an equally important question is whether individual incidents potentially residing within these constructs are capable of similar, individual juridical objectification. Each of these questions is important in its own right and have an impact on the proprietary dynamics of securities. Thus, the issue of juridical objectification itself must first be clarified.

Juridical objectification derives from the doctrine of subjective rights, which sought to emphasise the subject-*object* relationship as the most important legal relationship in circumscribing the nature and content of "private law rights and relationships" (i.e. the expanded view of the ambit of the domain

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321 This will be dealt with in detail below.

of subjective rights).[322] In South African law, the father of the doctrine is WA Joubert, who definitively saw private-law rights as a legal relationship between subject and object.[323] His work relies heavily on that of H Dooyeweerd,[324] to whom Joubert ascribes the following point of departure:[325]

> "*Dooyeweerd [stel] die subjektiewe reg as* die deur veroorlowende regsnorme gereguleerde beskikkings- en genotsbevoegdheid van 'n regsubjek oor 'n ekonomiese gefundeerde regsobjek in die samehang van geneemskaps- en maatskapsfunksies in die sin van vergelding."

This notion is directly assimilated by Joubert, and from it (as well as the influence of Dabin)[326] followed the traditional four-fold[327] classification of subjective rights in South African law: real, personal, personality, and immaterial property rights, identifiable according to their legal objects. Joubert summarises his theoretical outcomes as follows:[328]

> "*(1)* *Onmiskenbaar is die feit dat van subjektiewe reg alleen sprake is i.v.m.* regsverhoudinge tussen subjekte onderling; *die verhouding subjek-subjek is so vanselfsprekend van die subjektiewe reg as die bestaan van die reg as samelewingsorde.*
>
> *(2)* *Allesoorheersend by die subjektiewe reg is die* betrekking tussen regsubjek en regsobjek, *wat so duidelik spreek uit die onmiskenbare* verhouding *tussen die eienaar en sy saak maar by nadere analise in elke subjektiewe reg aanwesig is.*
>
> *(3)* *Die* inhoud *van die subjektiewe reg bestaan in 'n* genots- en beskikkingsbevoegdheid *van die subjek oor die objek van sy reg ooreenkomstig die norme van die 'objektiewe reg', wat daardie genot en beskikking reguleer deur 'n balansering van belange van regsubjekte onderling.*
>
> *(4)* Regsobjek *kan alles wees wat vir die reghebbende 'n ekonomiese waarde verteenwoordig in die sin dat dit vir hom gaan oor 'n relatiewe* skaarsheid *van die goed, wat nie noodwendig 'n geldelike* mark*waarde besit nie maar tog vir die reghebbende op geld waardeerbaar is.*
>
> *(5)* *Die subjektiewe reg, geleë aan die subjeksy van die reg, staan* selfstandig teenoor die die reg as norm, *maar sy* inhoud *word deur die regsnorme gereguleer…*

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322 Joubert (1958) *THRHR* 104-110; see also Van der Walt (1990) *THRHR* 316-317 n 1.

323 Joubert (1958) *THRHR* 104.

324 Specifically H Dooyeweerd *Encyclopaedie der rechtswetenschap* Vol. 2 (1967); and H Dooyeweerd "Grondproblemen in de leer der rechtspersoonlijkheid" (1937) 98 *Themis* 199 & 367.

325 Joubert (1958) *THRHR* 110 & n 62.

326 Specifically J Dabin *Le droit subjectif* (1952) 80-115 – see Joubert (1958) *THRHR* 112-114.

327 Until the addition of "personal immaterial property rights" as a fifth by one of Joubert's students – J Neethling "Persoonlike immaterieelgoedereregte: 'n nuwe kategorie subjektiewe reg?" (1987) 50 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 316.

328 Joubert 114-115 [own formatting].

> (6) *Van die beskikkings- en genotsbevoedgheid* oor 'n regsobjek *(subjektiewe reg) moet onderskei word die* bevoegdheid *in die sin van* kompetensie *(bv. handelingsbevoegdheid, bevoegdheid van 'n vader t.o.v. sy kind), waar geen subjek-objek-betrekking aanwesig is nie*.
>
> *Die deurslaggewende aspek van die subjektiewe reg is die betrekking tussen* subjiectum *en* objiectum iuris."

It has already been stated that this theoretical paradigm, despite its wide-spread acceptance, is of little problem-solving value.[329] Nonetheless, a measure of critical engagement with the doctrine is once again necessary to understand juridical objectification. This is also important for the following section's discussion of a functional possessory concept and other factual features of holdership. It is neither necessary nor appropriate to engage in a wholesale critique of the doctrine here. All that is required is a discussion of the doctrine's theoretical limits and problems as they relate to the issues at hand.

Of central importance is that "[c]oncepts of private law are intermediaries between facts and legal effects."[330] Even Joubert argued, correctly, that any "*regsbegrip*" must be developed with reference to the features of reality, but also in a scientific manner, subject to falsifiability (although without allowing practicality *or* overly legal-philosophical considerations to override a robust systemisation of legal concepts).[331] This does not mean the law cannot be practical. Instead, according to Lubbe, within the paradigm of juridical dogmatics:[332]

> "skep die sisteem *die vertroue dat die aanwending van regsbegrippe die moontlikheid bied om nuwe probleme deur middel van juridiese konstruksie op te los. Hiermee word bedoel 'n proses waardeur uitslae kreatief gegenereer word deur karakterisering van die regsaard van 'n situasie, dikwels aan die hand van verskillende regsbegrippe en die aanwending van verwante reëls. Die sogenaamde "rationale Expansionskraft" van algemene regsbegrippe en die verskynsel van sisteemsdwang dra by tot die vrugbaarheid van hierdie metodiek.*"

The legal nature of securities presents just such an opportunity for, as put above, "*rationale Expansionskraft*" in the face of potential systemic error (*sisteemdwang*).[333] The doctrine of subjective rights as found in the work of Joubert cannot adequately account for the proprietary dynamics of securities.

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329 See § 4 1.

330 F Schmidt "The German Abstract Approach to Law: Comments on the System of the *Bürgerliches Gesetzbuch*" (1965) *Scandinavian Studies in Law* 131, 139-140 – see Lubbe (1991) *Stell LR* 134.

331 Joubert (1958) *THRHR* 98-100; and Van der Walt (1990) *THRHR* 318 n 16.

332 Lubbe (1991) *Stell LR* 135 [own emphasis].

333 I.e. rational expansion in the face of systemic error.

A primary reason is that it does not adequately distinguish between economic *value* and socio-commercial *usefulness* in its approach to juridicial objectification.

The best illustration of the problem of legal objects being founded in economic value is the problem of personality rights. The defensibility of aspects of personality against infringement, in which success results in an award of economic value (*solatium*), lead Joubert to conclude that aspects of personality must have intrinsic economic value. For that reason, it was argued, personality could serve as the object of subjective personality *rights*. Here the influence of Dabin is also apparent. Dabin's fourfold classification of subjective rights was based on three characteristics: the subject-object relationship, implying the former's mastery over the latter; inviolability and enforceability; and juridical protection. His process in reaching this model placed less emphasis on the nature of the legal object than that of Dooyeweerd.[334]

The problem with aspects of personality is that personality's "economic value" is contestable. Most importantly, *solatium* is a(n economic) compensatory expression, or approximation, of non-economic suffering, rather than patrimonial harm (economic loss). This makes Joubert's position, fundamentally flawed on its own reasoning.[335] Tellingly, Dooyeweerd himself eventually revised his theoretical position, excluding aspects of personality from his taxonomy of legal objects. This was done on the basis of their lack of economic value and he consequently re-characterised personality rights instead as "subjective legal interests".[336]

If something has no economic value, it is – in Joubert's theoretical paradigm – *not capable of legal objectification*. As JD Van der Vyver argues, if all legal objects must have economic value, aspects of personality are not legal objects; if aspects of personality are legal objects, then the metric of economic value itself must be flawed.[337]

In a slight adjustment of the definition of legal object, an eminently workable solution was found. In light of these issues, FJ Van Zyl (with Van der Vyver in agreement) instead defines a legal object as:[338]

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334 See Joubert (1958) *THRHR* 112-114; Dabin (1952) 80-115; as well as PJ van Niekerk "Is persoonlikheidsregte subjektiewe regte?" (1990) 15(2) *Tydskrif via Regswetenskap* 28 for a far more nuanced, better exposition of this particular issue generally, and specifically his treatment of Dabin.

335 Van Niekerk (1990) *TRW* 29-38.

336 Dooyeweerd *Encyclopaedie* 173, 174, 179, 208, 209, 234; as cited also in Van Niekerk (1990) *TRW* 32 & n 16.

337 JD van der Vyver & DJ Joubert *Persone- en familiereg* 2 ed (1985) 11.

338 See Van Niekerk (1990) *TRW* 34 [own translation], citing in n 31 Van Zyl & Van der Vyver *Inleiding* 402-407; and in n 32 Van der Vyver & Joubert *Persone- en familiereg* 11 & 12, and Van der Vyver "The doctrine of private law rights" in *Huldigingsbundel* 226-231.

> "the aspect/facet/function of an entity ["entiteit"] which has legal value for a specific subject, on the basis that one or more extra-juridical uses ["waardes"] of that entity is legally designated ["bestem"] to bring about satisfaction of need ["behoeftebevrediging"], to the exclusion of all other legal subjects."

Accordingly, the concept "legal object" is reduced to the *dimension* of an "entity" (i.e. a conceptually ring-fenced phenomenon of reality such as a chair) which has *legal* rather than economic value. This legal value is, in turn, derived from its *extra-juridical usefulness* in satisfying a need. On this basis, the focus of the nature of subjective rights is shifted away from the nature of the object and towards the legal subject's ability to derive substantive determination and enjoyment from her relationship with that object.[339] This is a far more suitable approach. First, it replaces the concept of economic value with *extra-juridical usefulness.* Second, it shifts the focus back to the *content* of subjective rights: the dual entitlements of determination and enjoyment over phenomena that have use for legal subjects *inter se.* Third, it more appropriately reframes the entire issue as being a question of what the law is seeking to achieve – the delimitation of an interest in something which is of use (among competing interests).

In the pledge construction of the cession *in securitatem debiti* generally, the *beskikkings-bevoegdheid* serves as the legal object of the limited real right of security for a debt.[340] The patrimony locked up in the personal right as a whole remains with the holder of the *genotsbevoegdheid* – i.e. the pledgor. The object of the pledge is an entitlement of determination with respect to performance, but only a contingent right (upon default) to retain the benefits of such performance. Thus it is difficult to argue that this object has intrinsic economic value in the sense Dooyeweerd and Joubert envisioned: it is of *no patrimonial consequence* unless the primary debtor defaults. However, it certainly has extra-juridical usefulness: it provides the pledgee *access* to the underlying value of the performance through the ability to realise and enforce it, and the ability to benefit from that performance if and when a default-event occurs.

Thus it can be asserted that holdership of the ability to determine realisation and enforcement of the content of a right (a claim to performance) has extra-juridical usefulness, and thus *legal* value for its holder, and indeed others. It must, therefore, be capable of juridical objectification.

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339 As the two foundational entitlements of subjective rights – Van der Vyver en Joubert *Persone- en familiereg* 13; Van Zyl & Van der Vyver *Inleiding* 421; and Van Niekerk (1990) *TRW* 35.

This is also dealt with in § 4 1 1 as the source of many of a security's incidents.

340 This also shows, for instance, that the pledgee has *beskikkings-* and *genotsbevoegdheid* over the incidents of the *beskikkingsbevoegdheid* of the personal right serving *as the object* of her limited real right of pledge. This may seem, at first glance, absurd, but it is the *enjoyment* component of that limited real right that comes into effect if the pledgor cannot repay the debt and the security right of the pledgee is triggered, and it is over that object which a full free-standing limited real right comes into existence, complete with its own two-fold components inherent to private law rights.

This brings the discussion to the first useful theoretical outcome of this analysis: the legal objectification of the security instrument.

Holdership of the security instrument amounts to holdership of the equivalent of the entitlement of determination over the totality of that security's underlying interest; consequently, its *functionalities* are all incidents of execution of the security's complex of rights and other competencies. The entitlement of determination as the *ability to execute* the underlying interest has extra-juridical *value* for its holder and others. It must follow that it is similarly capable of juridical objectification without doing unnecessary violence to the underlying dogmatic structure of private law rights. Thus, holdership of the instrument is holdership, in the full sense, of a legal object (rather than, for instance, some amorphous *sui generis* modification of the holder's legal subjectivity).

Furthermore, doing away with the security instrument construct in favour of a mere relationship of agency, with or without positing "separate and severable" ownership(s), in explaining the legal nature of so-called registered-holdership is insufficient and unsatisfactory. It fails, inter alia but most importantly, to explain: (1) the issuer's exclusive relationship with the registered holder,[341] (2) the reason for, or source of, the *ex lege* relationship of agency (with fiduciary features) that automatically arises from the use of a nominee, (3) the requirement of registered transfer in completing the transfer of *security*-holdership,[342] as opposed to a mere formality of replacing one agent with another; or (4) why one of the methods by which securities can be pledged *in securitatem debiti* is through making the pledgee registered-holder.

Lastly, the *qualities* of the security instrument further show that it should be regarded as capable of juridical objectification. This instrument (separate from the asset) has, as is the case with corporeal things, the qualities of:[343] an impersonal nature, independence,[344] susceptibility to human control, and, as argued above, eminent usefulness. Further, in contrast to personality rights, the instrument is also *transferable*.

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341 "*Inderdaad is die implikasie van hierdie reëling dat die geregistreede aandeelhouer in hierdie opsig, byvoorbeeld met betrekking tot die opvordering van dividende wat deur die maatskappy verklaar is, as skuldeiser – en nie maar net as agent nie – aan te merk is. Die oënskynlike teenspraak in die erkenning van beide die geregistreerde aandeelhouer en die genottreker as skuldeisers van die maatskappy word uit die weg geruim indien ingesien word dat albei skuldeisers is, maar dan met betrekking tot afsonderlike komponente van die skuldeisersbelang."* – Lubbe (1989) *THTHR* 498 & n 79.

342 As per *Botha v Fick* 1995 (2) SA 750 (A).

343 See § 4 3 2.

344 "Incorporeals in the form of other rights only meet the requirement of independence if the requirement is widely interpreted as stating that the needs of legal practice determine what the law regards as independent." – Badenhorst et al *Law of Property* 29 (see also n 122). The suggestion that the "needs of legal practice" do indeed demand that the security instrument be regarded as independent *in this sense* is, of course, a central aspect of this entire work, specifically this chapter and the next.

In sum it is not possible to conceive of the security instrument, or even the more traditional notion of holding "registered ownership", without judicial objectification – despite the fact that on its own it does not appear to have any patrimonial dimension. Consequently it must also be capable of holdership in the full sense, though such holdership does not confer on its holder an asset.

The second useful theoretical outcome of this analysis, and of perhaps even greater importance than the soundness of the objectification of the security instrument, is further insight into what is, and is not, within the incorporeal paradigm, capable of juridical objectification. Simply: if something has legal value due to an extra-juridical usefulness which has been designated to satisfy a need to the exclusion of others, it can be objectified. Here a fine distinction must be made. Adherence to this definition does not *make something a legal object*, it makes it *capable of objectification* where legal subjects wish it and the positive law allows it.

What this then reveals when dealing with securities is that, given the appropriate context, juridical objectification can occur on three levels. First, the complex of rights and other competencies is capable of juridical objectification as the "security". Second, both the entitlement of determination and the entitlement of enjoyment are individually capable of juridical objectification as the security-asset and -instrument respectively. Third, at the level of incidents, any subsidiary incident-functionality which, if appropriately isolated, adheres to the definition is *also* individually capable of juridical objectification.

4 3 2 2 Factual features of holdership – effective factual control

With this in mind, the next step is understanding the factual features (and potential factual consequences) of the various forms of holdership of securities. As has been covered to some extent already, and is fully elaborated upon below, there is great complexity in the unique underlying structure of (the various forms of holdership of) securities. This causes the traditional constructs applied to obligations, and of cession and limited cession, to fall short in explaining all the features of holdership of securities, both factual and legal.

This section will outline the factual features of holdership. First, it will outline the legal functions of possession in the more traditional (corporeal) sense in order to understand what a functional analogue of possession in the securities context needs to achieve. Second, it will briefly contrast the two main competing viewpoints and taxonomies of the possession of corporeals – traditional common law possession, and a more modern scheme of "effective control" as developed by AJ Van der Walt. This is necessary in order to show (1) that the traditional, common law construct of possession (which inevitably informs the notion of *quasi-possessio* of incorporeals) has certain inherent inadequacies, driven mainly by terminological inaccuracy and an element of historical obsolescence; and (2) that a more modern "possessory" scheme centred around *control* has a number of advantages.

Third, on this basis, the section aims to show that the traditional concept of *quasi-possessio* is an insufficiently developed concept to deal with the various complexities of holdership in the securities context. However, due to the fact that *quasi-possessio* is ultimately informed by *control*, this will also show how Van der Walt's *control*-driven scheme may be used meaningfully to refine what is currently (and quite loosely) understood as *quasi-possessio.* Fourth, and most importantly, this theoretical basis will enable an exposition of a functional possessory construct (*effective factual control*) of the various potential legal objects to which securities may give rise – one which has problem-solving value and is robust in facing the complexities of the various legal relationships and acts securities facilitate.

Much of this discussion is implicitly informed by what appears to be the unusually strong proprietary character of securities compared to other obligations. This emphasised or enhanced proprietary aspect is driven by higher order socio-economic considerations regarding (1) the historic development of holdership and transfer of securities, and (2) securities' historic and present-day primacy among incorporeals[345] as an easily acquirable and transferable economic *asset.*

The proprietary dimension of securities is strongly tied to the prominent economic status securities enjoy as an important store of wealth. Securities are more comparable to movable property than, for example, ordinary contractual obligations. Further, securities' closer proximity to the "corporeal incorporeality" of negotiable instruments, if viewed on the spectrum of paper's effect on obligations, adds to their distinct proprietary character. The manner in which paper has historically come to be used as a proxy for this enhanced proprietary element of securities (specifically the certificate and instrument of transfer) in the mixed South African legal system is particularly instructive in this regard.

As will be shown below, the instrumentality of *both* certificated and uncertificated securities evinces a kind of control which appears almost more akin to control of corporeals than, for instance, obligations emanating from verbal contracts. The form in which control of securities manifests has interesting effects. For example, an *unlawful, mala fide* control of securities is made possible by the security instrument – something which would be hard to conceive of in most obligationary contexts.

This proprietary characteristic makes a coherent version of *quasi-possessio* specifically valuable and imperative, but also inevitably more complex. The fact that securities are treated "more like things" in a number of contexts is an important driver of the need for a more functional version for the current possessory construct as both a theoretical lynchpin and a practically useful tool. A truly *functional*

345 Rivalled perhaps only by immaterial property rights.

analogue must thus be consistent with the nature of the object in question, and in so doing have problem-solving qualities.[346]

Arriving at such a construct, however, requires a brief overview of the nature and functions of possession of corporeals, difficult as the topic of possession may be.[347] The concept of possession in the corporeal realm has been greatly debated, discussed, and written on; what follows offers a limited précis of the essentials. There appear to be two competing views (and correspondingly competing terminologies) regarding the possessory concept.

The first view is more traditional and common law-oriented. It is best concretised by ADJ Van Rensburg and CG Van der Merwe.[348] It ascribes to possession two elements: *animus* and *corpus*.

The latter, also known as the objective element, refers to the measure of effective physical control which the possessor must have over the object, a measure which varies depending on the circumstances (including the nature, size and purpose of the object) in question.[349]

The second, more decisive, element is the *animus*, or subjective, component. The traditional view takes a contextually variable view of the nature of possession:[350]

> "*[d]ie belangrikste poging om die besitsproblematiek op te los, is egter die standpunt wat vandag algemeen aanvaar word, naamlik dat een omvattende omskrywing van besit nie gegee kan word nie en dat besit vir elkeen van die funksies daarvan afsonderlik omskryf moet word.*"

Specifically, it is the particular quality of *animus* which lends each type of possession its character. Each form of possession has a different consequential function, and for each function only one of a specific subset of intention(s) will suffice, so that "the content [of the intention] depends on the particular legal consequence of possession which one has in mind."[351] In a more forward-looking

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346 However, care must be taken as to such a construct's *use*. For example, sight must not be lost of the principle that, as a point of departure, cession of incorporeals requires no formalities akin to (constructive or true) delivery or registration to effect a valid real agreement. This has also been held to be true of the full cession of a share, and indeed any security – see *Botha v Fick* 1995 (2) SA 750 (A). Any approach not in line with this principle should be approached in a circumspect manner. Yet this is a topic more appropriate for the following section and Chapter 8.

347 Very well described by Van der Walt in (1990) *THRHR* 276-277.

348 See ADJ Van Rensburg & CG Van der Merwe "Die aard van besit en die *animus*-element daarvan" (1978) *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 113; as well as Van der Merwe *Sakereg* 89-112. It is further, but less emphatically, followed in Badenhorst et al *Law of Property* 253-266 (Chapter 12 - Possession).

The traditional view's best treatment, however, is found in Van der Walt (1988) *THRHR*, although it is a summary and this is the source from which the opposing view originates.

349 Van der Merwe *Sakereg* 97-9; Badenhorst et al *Law of Property* 255-258; see also Van der Walt (1988) *THRHR* 287.

350 Van der Walt (1988) *THRHR* 283.

351 Badenhorst et al *Law of Property* 259, but more fully 258-264; Van der Merwe *Sakereg* 103-106; and Van der Walt (1988) *THTHR* 286-295.

sense, the above would seem to imply an open-ended concept of possession, with currently crystallised forms for currently understood consequence-creating functions. These functions are a key aspect of the overall outcome of this section and the next and can be dealt with in this precursory portion of the discussion (alongside the various types of *animus* which go with them). The functions which have no clear applicability to securities have been omitted.[352]

The first is the real (*saaklike*) function, centred around original or derivative acquisition of *ownership*. In order for the legal consequences of ownership to flow from the factual control either held or acquired by the acquirer, such control must be accompanied by *animus domini* (the intention to become owner). In accordance with the traditional view, this function circumscribes the required type of intention, thereby defining this type of possession.

The second is the security function (*sekuriteitsfunksie*), referring to the creation of real security. Here, generally, factual or objective control must, it appears, occur alongside the intention either to retain physical control for own advantage (*animus sibi habendi*) or to derive benefit (*animus ex re commodum acquirendi*) in order to bring about the legal consequence of real security. Again, these types of intention delineate the corresponding type of possession required.

Third is the evidentiary (*bewysregtelike*) function, which is based on the principle of publicity. Relevant authorities tend to focus on its function with specific reference to possession forming the basis of a presumption of ownership, and thus ascribe the *animus domini* as the applicable requirement. However, there appears to be no reason why the corresponding intention cannot be extended based on the evidential necessities at hand – for example, possession with the *animus sibi habendi* could fulfil an equally useful evidentiary function where a third party has placed reliance on possession as evidence of real security, and seeks to show the reasonableness of that reliance.

Fourth is the more contentious legal-political (*regspolitiese*) function. Briefly, this is a policy-oriented function of possession focused on the maintenance of social order and cohesion by protecting the status quo on the basis of such possession. However:[353]

> "*[d]ie kernvraag is of die regspolitieke funksie van besit, soos dit in besitsbeskerming vergestalt word, net op die mandament van spolie betrekking het en of ander remedies ook daarmee verband hou…Gewoonlik word die regspolitieke funksie van besit gekoppel aan die handhawing van ongekwalifiseerde besit teen onregmatige versteuring of ontneming daarvan. Die meeste bronne vermeld die feit dat hierdie summiere*

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[352] For the sake of convenience, coherence and brevity, the views of the relevant authorities will be synthesised in what follows, without any more particular reference; although the structure of Van der Walt's neat summary (286-295) will be relied upon to inform the form and order of the discussion.

[353] Van der Walt (1988) *THRHR* 288 & 289.

> *handhawing of herstel van die* status quo *op regspolitieke oorwegings berus…Daar bestaan egter onduidelikeheid oor die doel van besitsbeskerming*."

As a result of its unclear scope and possible fluidity, the precise nature of the *animus* required to fulfil this function is not always certain, although it appears that most forms of conscious intent beyond mere awareness would seem to suffice if appropriate for its purpose. This function need not be dealt with here any further, as once the outcomes of this section become clear, it may form the basis of a discussion of the protection of *bona fide* unlawful holdership in the securities context (see Chapter 11, and to some degree Chapter 10).

Fifth, and last for present purposes, is the restitutive function (*vergoedingsfunksie*), in which possession plays a material part in the successful pursuit of any applicable delictual claim. Here, similarly, there is evidence of a relaxed approach to the necessary intention in order for this possessory function to have legal consequences.

What should be clear from the above is not only that possession fulfils a multitude of vital functions in determining the availability, or legitimacy, of certain legal relationships and consequences, but also that to some degree "*die verskillende funksies nie goed van mekaar onderskei word nie, en ook nie baie duidelik omskryf word nie*."[354]

For this reason, Van der Walt proposes a significant restatement of the possessory construct, both in nature and terminology.[355] In this second of the two competing views, possession is relegated to status as one of many consequences of a more foundational concept – *effective control* of a corporeal. Thus Van der Walt's view, echoed in Van der Walt & Pienaar, inverts the typology, making control the core construct (comprising of effective physical control and the necessary *animus*), with all else flowing from it:[356]

> "the distinction between ownership, possession and holdership is explained with reference to lawfulness and the intention of the controller in each case…ownership and lawful holdership [all other real rights] are lawful forms of control, whereas possession and unlawful holdership are unlawful forms of control.

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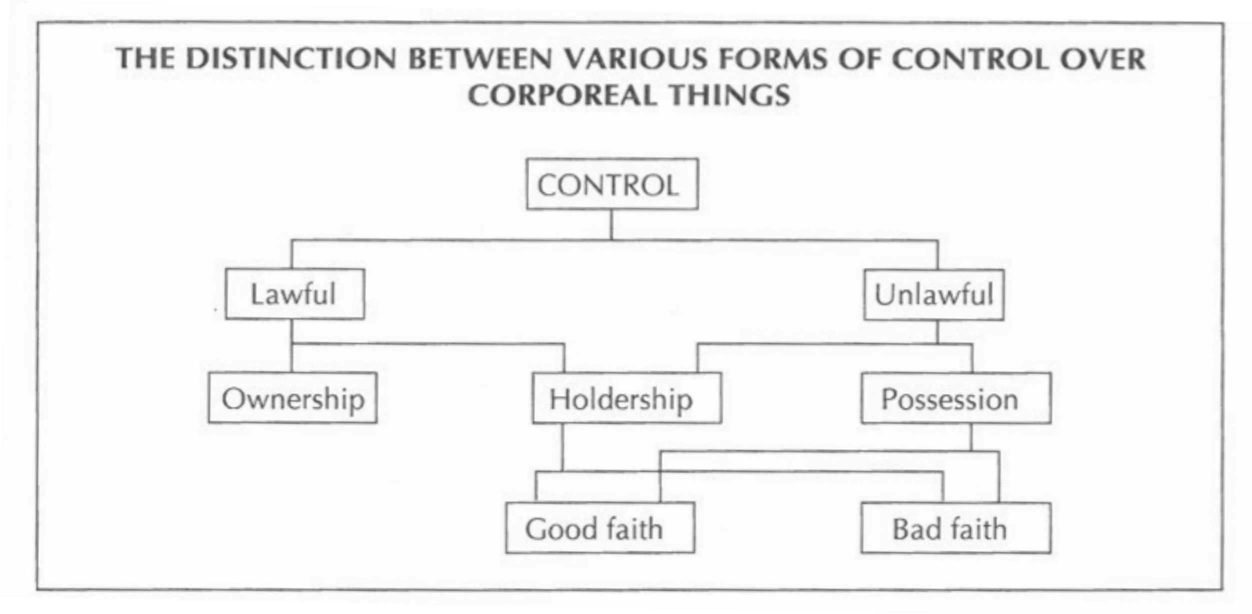
354 Van der Walt (1988) *THRHR* 295.

355 Van der Walt (1988) *THRHR* 508 *et seq.* (Part II); see also Van der Walt & Pienaar *Property* 169-175.

356 Van der Walt & Pienaar *Property* 179-180.



…

The concept of physical control does not apply to rights in incorporeal property, and it is not necessary either, because these rights in property are held and exercised in an abstract manner, not physically."

The underlying premise of this restatement is outlined as follows:[357]

"*Die funksies wat besit in die samelewing vervul, het sedert die die derde eeu ingrypende veranderinge ondergaan. Soos in die geval van eiendomsreg sou dit onrealisties wees om te veronderstel dat besit die selfde funskie kan vervul in twee samelewings wat so ingrypend van mekaar verskil as die Romeinse en die moderne.*

…

As gevolg van die onvermoë van die bestaande regsistematiek en besitsteorie om die waardverskuiwings ten aansien van die saakgebruik in die moderne lewe te akkomodeer, word tradisionele regsfigure soos besit oorspan in 'n poging om die sistematiese en terminologiese tekortkominge in die huidge besitsteorie te oorkom.

…

Een van die belangerikste terminologiese probleme wat in 'n alternatiewe benadering opgelos moet word, is om 'n aanvaarbare oorkoepelende begrip te vind waarmee besit*, in die sin van 'n algemene verwysing na die daadwerklike of feitelike "besit" van die eienaar, die besitter met eienaarsbedoeling, die huurder, en alle ander "besitters" vervang kan word. In die regsliteratuur word* besit *gebruik om hierdie oorkoepelende funksie te vervul, maar dit is onaanvaarbaar in die lig van die feit dat 'n enger betekenis in spesifieke*

357 Van der Walt (1988) *THRHR* 508, 509 & 510 respectively.

> *kontekste aan dieselfde begrip geheg word…Daar bestaan 'n alternatiewe begrip wat hierdie funksie kan vervul. Die begrip* beheer…"

From this central concept (comprised of both a physical and mental element), which refers to all factual property law relationships and is free from historical baggage,[358] all others emanate. Crucially, it retains the variability of intention found in the common law view, without its conceptual and terminological uncertainty.

In the scheme of effective control, the first additional distinctive quality is whether the control is lawful or unlawful. From this distinction "possession" becomes ownership's unlawful counterpart (unlawful control with *animus domini*), whilst all secondary property relationships are either lawful or unlawful forms of "holdership". The second distinguishing factor is whether control is in good or bad faith (as even lawful control may be in bad faith, although this is seldom of legal consequence).

This second approach does not do away with what should now be termed the functions of control (rather than possession). However, its key advantage is that it retains the pure factuality which the traditional possessory concept attempts to convey less successfully:[359]

> "*[i]n hierdie sin is* beheer *kennelik 'n suiwer feitelike gegewe en geen nadere besonderhede oor die regsaard daarvan word verskaf nie. Die regsgevolge wat aan sodanige beheer geheg kan word, kan ook nie sonder meer impliseer dat dit 'n saaklike reg daarstel nie.*"

Whilst neither view is universally accepted, it would seem as though the latter is not, despite its more useful and internally coherent logic, the dominant one. However, the present context need not make any determination on this issue, as the goal is finding an appropriate proprietary analytical framework for holdership of a particular kind of *incorporeal* – securities. In this regard, Van der Walt's scheme is undoubtedly superior.

Take, as point of departure, the following statement:[360]

> "*Regmatige beheer kan op 'n saaklike reg of op 'n vorderingsreg berus.*"

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358 Van der Walt (1988) *THRHR* 512.

359 Van der Walt (1988) *THRHR* 512.

360 Van der Walt (1988) *THRHR* 513.

See also CG Van der Merwe "Things" in JW Scholtz (ed) *Law of South Africa* 2 ed (2015) Vol 27 § 70, citing: Grotius 2 2 5; Voet 41 2 11; Zoesius *Commentarius ad D* 41 2 par 6; Kersteman *Woordenboek* 97; *Shapiro v SA Savings & Credit Bank* 1949 (4) SA 985 (W); *Sebastian v Malelane Irrigation Board* 1950 (2) SA 690 (T); *Painter v Strauss* 1951 (3) SA 307 (O); *Slabbert v Theodoulou* 1952 (2) SA 667 (T); *Van Rooyen v Burger* 1960 (4) SA 356 (O); *Rooibokoord Sitrus (Edms) Bpk v Louw's Creek Sitrus Koöperatiewe Mpy Bpk* 1964 (3) SA 601 (T); *Jansen v Madden* 1968 (1) SA 81 (GW); *Van Wyk v Kleynhans* 1969 (1) SA 221 (GW); *Beukes v Crous* 1975 (4) SA 215 (NC); *Bon Quelle (Edms) Bpk v Munisipaliteit van Otavi* 1989 (1) SA 508 (A); *Zulu v Minister of Works, KwaZulu* 1992 (1) SA 181 (D); *Plaatjie v Olivier* 1993 (2) SA 156 (O); and *Du Randt v Du Randt* 1995 (1) SA 401 (O).

Effective control is a manifestly appropriate construct in the context of incorporeals.[361] This also appears to be compatible with the law as it currently stands – supported by an abundance of authority is the following:[362]

> "Because of the physical nature of possession it can only be exercised with regard to physical or corporeal objects. However, the law also recognises so-called *quasi*-possession or juridical possession (*possesio iuris*) *which consists in the exercise of control over an incorporeal coupled with animus to exercise such control*. Factual control of an incorporeal is exercised whenever the thing is exploited in accordance with an actual or presumed legal right (for example, a servitude or a contractual right of use) with regard to the thing."

More importantly, *quasi-possessio* has been a central feature of a number of cases dealing with "law of things" constructs as applied to securities. Again using the pledge *in securitatem debiti* as lodestar, the:[363]

> "limited cession invests the cessionary with control over the economic value inherent in the debtor's performance, and as such provides the basis for the recognition of a real right of pledge in favour of the cessionary…[further in n 366:] This enables the cessionary to 'hold' rather than 'own' the ceded claim…*References in decided cases to the transfer to the cessionary-pledgee of* quasi-possessio *of the right confirm the impression that the cession of such a limited interest is the functional equivalent of the transfer of physical possession to the pledgee in the case of a pledge of corporeal moveables…This also seems to be the consideration underlying traditional practices regarding the utilisation of shares as security.*"

This is most evident in *Moonsamy v Nedcor Bank Ltd*, which explicitly deals with the handing over of *quasi-possessio* of the right in pledging securities *in securitatem debiti*.[364]

However, other cases, operative in different contexts, further reinforce the deeper point. *Tigon Ltd v Bestyet Investments (Pty) Ltd*[365] (addressing the so-called "quasi-spoliation" of securities) and *Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd*[366] (dealing with the so-called "quasi-*rei vindicatio*" in the securities context) also show how *quasi-possessio* serves as an indispensable intermediary to the application of these corporeal principles to securities.

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361 Its central importance in Lubbe's theoretical account of the pledge-style security cession, as discussed at length in this Chapter, should make this abundantly clear.

362 See above, as well as Badenhorst et al *Law of Property* 275, n 93 [own emphasis].

363 Van der Merwe et al *Contract* 430 & n 366 [own emphasis]. It is unclear whether this comment is intended to impose further substantive requirements upon such limited cessions. This will be briefly dealt with in Chapter 9.

364 2004 (3) SA 513 (D) 517.

365 2001 (4) SA 634 (N).

366 1976 (1) SA 441 (A).

In the unique and challenging context of securities, *quasi-possessio* in its current form is not suitable for application to securities. Its precise meaning is not clear, and it has no accompanying body of clarifying jurisprudence. For instance, to simply state that "*quasi*-possession…consists in the exercise of control over an incorporeal coupled with *animus* to exercise such control" does not take any theoretical account of the legal nature of securities. It also does not take cognisance of the fact that control over different incorporeals may manifest in vastly different ways. In so doing it inevitably fails to account for core differences arising from the unique underlying structure of securities. It is this structure which makes the precise nature of control of securities or subsidiary elements of securities a key lever in understanding the legal nature of securities generally.

Moreover, perfectly illustrative of this point, is the accompanying statement above that "[f]actual control of an incorporeal is exercised whenever the thing is exploited in accordance with an actual or presumed legal right". This statement is certainly incomplete (perhaps even incorrect) as unlawful, *mala fide* control of a security is demonstrably possible due to the existence of the security-instrument. This shows that control is not always exercised in accordance with even a "presumed right".

What the common law does seem correctly to emphasise is the element of control. This, alongside the proprietary dimension of securities, brings one to why Van der Walt's scheme (with the necessary modification for application to incorporeals) is so analytically valuable. It provides a far more powerful platform than the existing common law paradigm of (possession-informed) "*quasi-possessio*" for the formulation of a functional possessory construct for securities. Using Van der Walt's analytical framework in the present context comes without the doctrinal contention it may have in law of things context. Its use in the current context also has a great deal of problem-solving value. However, it must not be forgotten that despite their more pronounced proprietary aspect, securities remain, primarily, governed by the rules and principles of the law of obligations, *unlike* negotiable instruments.

From the above, *"effective control"* emerges as the most suitable and effective tool. Why? First, it would function to replace the aptly labelled "*drogbegrip*" of *quasi-possessio* discussed above,[367] doing away also with the influence of the already unclear traditional concept of "possession". Second, more theoretically, it would also serve to rationalise and explain other instances where the proprietary aspects of securities cause doctrinal opacity,[368] bringing much needed legal certainty

367 I.e. "sham concept" – as per Lubbe (1989) *THRHR* 492 n 42.

368 Such as the deeper underlying legal nature and function of the valid acquisition of uncertificated securities by a *bona fide* transferee despite any defects, such as any fraud or illegality, as guaranteed by s 41 of the FMA and s 53(4) of the Companies Act of 2008.

Yet there is no better example of this that the need to rationalise the flawed *ratio* of *Tigon Ltd v Bestyet Investments (Pty) Ltd* 2001 (4) SA 634 (N). See Chapter 11 in this regard.

and clarity to what is currently an unsatisfactorily fluid legal landscape. Third, it would facilitate further legal development without the need to continually revise and reformulate common law constructs that have become redundant and inappropriate because of modern legal and commercial developments. Fourth, it allows for a more sensible understanding of the theft of securities as incorporeals.[369]

In this light, the most pressing issue is to determine what would constitute *physical control* in the context of securities. To do so, the function of physical control needs to be understood. Physical control is primarily attributed a *publicity* function.[370] This function, for obvious reasons, informs and enhances a great number of the broader functions of effective control (such as its real, security or evidentiary functions).

Yet when dealing with obligations, publicity is often viewed as of lesser importance. For example, in the context of the pledge of claims *in securitatem debiti,* it has been argued that:[371] (1) publicity is not the overriding policy reason for requiring control; (2) publicity has become at best an attenuated requirement for the vesting of real rights even in the corporeal context; and (3) the handing over of *control* over the pledge object sufficiently "isolates" the pledge object against future acts of use, enjoyment or enforcement by the cedent.

Despite this, *securities in particular* have a number of qualities requiring a more pronounced publicity function than may be necessary for most obligationary objects.

The first is that securities are, to a large degree, objects of *trade and wealth*. It is in this sense that securities appear most like corporeal things both in law and commerce. The importance of the principle of publicity in effecting valid transfer is well established in the law of sale (evident both through registered transfer of immovable things and the requirement of delivery in the transfer of movables).[372] It follows that the elevated importance and prevalence of sale in the commercial sphere implies an increased emphasis on publicity in the legal sphere.

Second, publicity plays a key role in defending holdership and by implication defending wealth. It is vital in establishing the reasonableness of a reliance in founding a defence of estoppel against the *rei vindicatio*. A good illustration of the application of that principle here, as will be shown in Chapter

369 More a useful discussion of this issue see Yeats et al *Commentary 2008* at 2-847 – 2-848 and attendant footnotes.

370 Badenhorst et al *Law of Property* 259; and Van der Walt & Pienaar *Property* 185.

371 Lubbe (1989) *THRHR* 490-491 & n 36.

372 See for instance CG Van der Merwe "Things" in JW Scholtz (ed) *Law of South Africa* 2 ed (2015) Vol 27 § 10, 219, 227 & 229.

10, is that estoppel is a prominent feature in the realm of certificated securities, specifically in the context of the *quasi-rei vindicatio.*

Third, the underlying structure of securities allows for nominee holdership (as instrument-holdership). The use of a nominee can easily cause the true "owner" (asset-holder) to be hidden from the view of third parties dealing with the instrument-holder. In order to mitigate this risk and promote legal certainty, greater publicity may be required.

Fourth, and last, securities also perform an important real security function in commerce, and one which is becoming increasingly important in the global economy.[373] However, the form-free nature of South African cession coupled with the transactional dangers of nominee-holdership seem to militate in favour of an enhanced element of publicity in the cession *in securitatem debiti* of securities (most importantly when dealing with certificated securities).[374] Thus publicity seems eminently necessary as a feature of the law relating to debt securities. This will be returned to below in discussing the true role of the security certificate.

However, it is submitted that effective physical control also fulfils a deeper function, to which its publicity function is innately tied. This is alluded to by CG Van der Merwe in discussing the function of publicity in the law of things:[375]

> "[o]ne of the aims of the law of things is to publicise the legal relationship between a person and a thing and thus to effect a *correspondence between the legal and the factual situation*."

Corporeals exist physically. The law *as an abstract phenomenon,* and in a sense reactive to that reality, fashions policy, principles, and rules to subjugate these physical phenomena to its abstract systemisation. By way of gross over-simplification, it does so by circumscribing them in its own terms, thereby enabling the assimilation of the "legal abstraction of the corporeal" into the law. Seen thus, physical control of corporeals is a legal construct existing to assimilate a purely factual state of affairs into a legal fact, in order to build or apply positive law rules to it.

The nature of obligations as phenomena dealt with by the law is vastly different from corporeals. Obligations, as creatures of law innately, are subject to the positive law *a priori*, rendering such an assimilation unnecessary. This, however, does not imply that it is unnecessary (or impossible) for the law to be able to delineate a *factual* state of affairs regarding these more abstract legal objects. This is simply an argument for why the policy-mix underlying the law of obligations does not seem

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373 See § 4 3 2 above.

374 See the discussion regarding the role of the security certificate in the final section below.

375 Van der Merwe "Things" in *LAWSA* § 10 [own emphasis], referring (n 1) also to KGC Reid "Obligations and property: exploring the border" (1997) *Acta Juridica* 225 236-237.

to treat it as imperative in the manner that the law of things does. For example, a publicity-driven requirement such as *traditio* is not found in the law of cession, but in light of the above it would still seem that publicity has a great deal of use and value in the securities context. The pronounced presence of the *quasi-possessio* construct in securities case law, serving as a mediator for the use of certain of property law principles, shows as much.

However, its nature will be very different to that of effective physical control of corporeals.

Whilst it is tempting to argue that holdership of the security instrument itself is the equivalent of physical control, this is not so. This argument appears intuitively appealing, first, due to the security instrument's superficially close resemblance to the function of paper as the conduit of physical control in the realm of negotiable instruments. Second, the natural connection between execution (arising from the entitlement of determination) and control also makes the argument seem stronger than it is. As the locus for (holdership of) the incidents of execution, the instrument bestows determination over a security – and therefore the proximate ability to realise the underlying interest to the exclusion of all others. Who, other than this holder, could be in control of the security in a manner *factually* analogous to effective physical control? The answer to this question lies in the purpose of the security instrument, the nature of the underlying interest, and the unique nature of the legal relationship between asset- and instrument-holder.

From an economic perspective, it is now clear that the security instrument developed to function as a mechanism to reduce the initial and on-going economic costs of borrowing from a large number of separate lenders. The legal solution, as argued in the previous Chapter,[376] to this (primarily transaction- and monitoring-cost driven) problem, was to insulate the issuer from the true legal state of affairs behind the "veil" of the security instrument, allowing the issuer to have *all* its legal relations vis-a-vis the security with the instrument-holder alone. Such an arrangement is far more economically efficient. All that has changed throughout securities' modern development is that the instrument now functions to reduce the economic costs of securities-driven borrowing in the primary market *and* the transfer of those securities at high velocity and volume in certain secondary markets (i.e. trading).[377]

This does not mean that holdership of the incidents of execution *as a legal state of affairs*, as a legal solution, can be conflated with control *as a factual state of affairs.* Unlike corporeals, securities are complex composite patrimonial objects, constituting bundles of rights and competencies. It has been shown that the interest underlying such a bundle is further divisible into entitlements of determination

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376 See Chapter 3, § 3 1.

377 Security of transfer is also an important economic factor in this regard. One of the (perhaps unintended) consequences of the security instrument was that it very effectively enabled quick *and secure* transfer of these incorporeal assets, whereas most incorporeal patrimonial objects were harder to transfer so securely.

and enjoyment (enabling, incidentally, the creation of the security asset and instrument), and even further divisible into the various incident-functionalities which flow from those entitlements. It has also been shown, in the previous section, that each of these subsidiary elements has the potential, depending on the factual matrix in question, to be regarded as a *legal object*.[378]

It must follow that different elements of a security may be controlled by different persons *simultaneously* (each of these forms of control existing over separate subsidiary elements of that security). Any incorporeal equivalent of the concept of physical control must accommodate this crucial difference (as compared to corporeals), and such a concept could almost never indicate who controls all of the *security* at large, unless all elements of that security were under the control of one person. The only situation in which this could hold true is when dealing with a *security*-holder (i.e. both asset- and instrument-holder) who has not granted any further interests in securities to third parties.

Further, to vest a real right to such a legal object, that object, rather than the security as a whole, must be "isolated" against encroaching future legal acts by the object-giver or other external parties. This is achieved, at least practically,[379] by the handing over of effective control.

Thus the most appropriate functionally equivalent construct to physical control is in fact *effective factual control of the legal object in question*. Thus the legal nature of effective control of securities can be found in the relationship between asset-holder and instrument-holder (i.e. an "implied *sui generis* form of agency" with a strong fiduciary dimension).[380]

Within the control-based taxonomy (reflected also in the more traditional version of *quasi*-possession), control must be accompanied with a required *animus* component. Specifically, for corporeals, physical control with "the intention to hold for a principal" will be insufficient to establish the *animus* requirement which completes effective control.[381] This is because factual intention is deemed insufficient to make a *legal fact* of the physical control.

The previous conclusions of this chapter[382] show that the instrument-holder acts as representative for the asset-holder despite exercising, by virtue of holdership, the incident-functionalities of execution in own capacity. This is done through holdership of the security-instrument as legal object. If, as it must be, the same *animus* requirement applies to the effective factual control of securities,

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378 See § 4 3 2 1 above.

379 See also Lubbe (1989) *THRHR* 490-493 (§ III). This point will be discussed in Chapter 9.

380 See § 4 3 1 above.

381 The remaining principal requirements of the *animus* element of control are: mental capacity; conscious control; a specific intention (to hold as owner, or for own benefit) – Van der Walt & Pienaar *Property* 187-190.

382 See § 4 3 1 above.

then the instrument-holder's ability to execute the underlying interest on the asset-holder's behalf is *not enough* to establish effective factual control over the security or any of its incident-functionalities.

This leads to the conclusion, finally, that the most functionally appropriate possessory construct in the securities context must be *effective factual control over the instrument-holder,* coupled with the necessary mental element(s) of control as already established through common law (though, again, they are not to be regarded as a *numerus clausus*). Control will always be determined with reference to the particular legal object in question. The effective controller of a security is the factual controller of the instrument-holder for that general purpose; the effective controller of a subsidiary element of a security (such as its income stream, or *fructus*) in turn is the effective controller of the instrument-holder for that more specific purpose.

Once that view is adopted, an instrument-holder could *factually* (and unlawfully) break with that fiduciary agency by changing the intent with which the security instrument is held. Thus, for example that holder is able in theory to unlawfully usurp effective control of the security by exercising her control over the instrument-holder (i.e. herself) *animus domini.*[383]

Further, in the discussion thus far it would appear implicit that the scheme of agency inherent in asset- and instrument-holdership entailed the representation of the asset-holder in the entirety of the underlying interest. This assumption may now be left aside, as representation may occur in respect of any legal object stemming from the underlying interest of a security. *Lawful* control is achieved via modification of the scheme of agency to add the representation of a third party (in respect of some more limited aspect of the security's incident-functionalities) to the arrangement. *Unlawful* control is securing the co-operation of the instrument-holder for specific or general purposes *without* a legal basis.

Of final and fundamental importance, it is chiefly on analysis at the level of incidents that the concept of effective control as a functional possessory construct is fully vindicated. The point is fairly simple, yet quite powerful: various elements of a security may be subject to the control of different persons simultaneously, *but the same cannot be said of incidents.* It is in the nature of incidents, as individualised legal objects, that each may only be controlled by one person at any given time. Therefore, it makes doctrinal and, more importantly, *pragmatic* sense to regard control over those incidents to *flow via*, rather than *reside in*, the instrument-holder.

383 Van der Walt & Pienaar *Property* 189 – "[i]n certain cases [the agent's] position might become relevant, especially when a conflict develops between principal and agent."

It should also be mentioned here that, as a result, lawful *or* unlawful control may be established *de facto* through instrument-holdership itself, but as a *consequence* of this principle rather than (as dealt with above) an argument for such holdership *as* effective factual control.

It is appreciated that, at first glance, this is intuitively unappealing. However, it is a theoretically quite precise conclusion, and is best illustrated using a number of examples. To do so, a final word on the correct terminology in terms of Van der Walt's control taxonomy as applied here is helpful. In the present context, *holdership* should be taken to indicate the incorporeal equivalent of lawful "ownership", *quasi-possession* then the equivalent of unlawful control *animus domini*, and finally *interest-holdership* must indicate all other lawful or unlawful equivalents of third-party interests in securities.

Thus, by way of example, through exercising control over the instrument-holder with the requisite *animus*: (1.1) the pledgee or usufructary of a security is a lawful interest-holder, or (1.2) a person factually receiving proceeds from holdership of a security without a lawful *causa* (typically due to the lack of a lawful basis and consequent formal modification of the scheme of agency between instrument-holder and asset-holder) is an unlawful interest-holder; and (2.1) the *bona* or *mala fide* acquirer of a security, may be either the asset- or security-holder (if lawfully acquired), or (2.2) the *quasi-possessor* (if unlawfully acquired).

Lastly, and quite decisively, the incidents of execution residing in the security instrument *as object*, cannot be individually severed and disposed of. This is made so by the structural features of that object, specifically its function *vis-a-vis* the asset-holder, third parties with holdership of interests in securities, and most importantly the issuer, respectively.

Securities registers simply do not allow for fragmented *instrument*-holdership, and it does not appear possible as a matter of principle and policy for elements of the security instrument to be held by someone other than the instrument-holder. In order for it to fulfil its economic and legal functions effectively, is must operate as an indivisible legal construct, held by a single person. If this were not the case, and the locus for holdership of the incidents of execution could be fragmented, there would be an unacceptable degree of legal uncertainty as to the control and exercise of, as well as the entitlement to benefit from, the underlying rights, other competencies, and subsidiary incidents of securities.

4 3 2 3 Certificated securities – the role of the certificate

The only outstanding factual feature of holdership, in light of the above, is the role of the security certificate in the context of certificated securities. It is uncontentious that the security certificate's primary role is to serve as *prima facie* evidence of instrument-holdership. In this evidentiary function, the certificate serves as *prima facie* proof of instrument-holdership,[384] and is proof which will, from a procedural perspective, be elevated to an established legal fact unless evidence to the contrary is presented.[385]

However, 19th century English law jurisprudence clearly articulated that the full function of this physical piece of paper goes somewhat further than that. This observation draws once again on the law as it relates to shares because of the share-centric bias of South African law and the resultant convergence of all (registered) securities on share-based legal principles.

From an economic perspective, in accordance with a classical dictum of the English courts:[386]

> "[the power of granting certificates is to give the shareholders the opportunity of more easily dealing with their shares in the market, and to afford facilities to them of selling their shares by at once showing a marketable title, and the effect of this facility is to make the shares of greater value…[it is] a declaration by the company to all the world that the person in whose name [it] is made out, and to whom it is given, is a shareholder in the company, and it is given by the company with the intention that it shall be so used by the person to whom it is given, and acted upon in the sale and transfer of shares…"

This begins to make increasing sense of the argument for the importance of publicity as presented above. On a foundational level, the importance of the publicity construct flows from the deeper principle of legal *certainty*, which is of increased importance in the highly transactional commercial environment that securities inhabit. As shown in Chapter 3, the legal development of the securities construct over the last hundred years shows that the securities *register* evolved from the legal necessity of turning novation into a useful transaction-cost saving device in the ordinary course of commerce. However, what it also shows is that the *certificate* (as the second component of the certificated security instrument) developed to lend certainty, through enhanced publicity, to securities transactions and holdership.

This yields a core insight regarding the role, or functionality, of the certificate. The paper itself is corporeal and physical, and serves to *represent* in *tangible form* what remains an *intangible legal state of affairs*. Thus, by visibly indicating the "invisible" legal position, publicity is achieved,

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384 In Delport *Henochsberg 2008* § 51, 208 it is phrased as "ownership (not title)…".

385 See for instance Blackman *Commentary* § 94, 5-264 & n 2; *Ex parte The Minister of Justice: In re R v Jacobson & Levy* 1931 AD 466 478; *Marine & Trade Insurance Co Ltd v Van der Schyff* 1972 (1) SA 26 (A) 37–38; or *S v Veldthuizen* 1982 (3) SA 413 (A) 416.

Importantly, as cited by Blackman et al in n 2, *Watt v Sea Plant Products Ltd* 1994 (4) SA 443 (C) 453 makes it clear that the exact same principles apply to "debentures and debenture certificates". Incidentally, it bears pointing out that the terminological issues necessitating the "and…certificates" formulation found in the case have also been resolved in § 3 1 of this Chapter.

386 *Re The Bahia & San Francisco Railway Co Ltd* (1868) LR 3 QB 584 594–595.

strengthening legal certainty in concluding juristic acts in the context of securities. The strength of this indication varies contextually, but the principle runs through every established function of the certificate. It is the ultimate manifestation of the proprietary thinking that seems so implicitly to have emerged over a hundred years of application of South African law to shares, debentures, and then finally securities. In essence the security certificate, seen thus, appears to have evolved in order to imbue a "weak corporeality" to securities. In this sense it serves as a good example of the observation that "certain legal usages transcend their original purpose and take on new, wholly justifiable roles."[387]

Providing securities with a weak corporeality facilitated an easier application, directly or indirectly, of principles of the law of things which were not only vital to securities' efficacy in the commercial sphere, but also not fully achievable within the doctrinal constraints of the South African law of obligations. This is in no small measure due to the fact that the domestic law's doctrinal path resulted in securities which are not negotiable, despite the more Civilian character of South African private law.[388]

For example, it is typically (although no longer legally)[389] required for the valid transfer of the security *instrument* (so-called "registered transfer") that a valid instrument of transfer is accompanied by the transferring holder's security certificate. Another instructive manifestation of this underlying set of norms is the key role of the certificate in establishing the reasonableness of a reliance in the context of estoppel.[390] The certificate's *procedural* role as prima facie evidence of "title" (instrument- or

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387 Chapter 2, § 2 2 1.

Uncertificated securities were only formally introduced in the mid-1990s. Their inception occurred because, at that point, the state of commerce necessitated further structural intervention into the underlying nature of securities. This policy intervention was in any event mainly limited to the trading of securities on formal trading platforms, where the inherent safeguards and utility provided by the publicity function of the certificate were supplanted by other measures. In all other spheres of commerce, (certificated) securities *still* require these functionalities in order to function effectively.

388 See § 4 1 3 (citing also elements of Chapter 3, § 3 2).

389 In the context of company securities, a 14(b) of Table B, Schedule 1 of the Companies Act of 1973 entitled the directors of a private company to refuse a share transfer if the instrument of transfer was not accompanied by the share certificate. Neither the 2008 Act nor its Regulations contain a similar provision.

For the transfer of "shares and debentures" authorities such as A Milne *Henochsberg on the Companies Act* 3 ed (1975) 185 & 233; and Blackman et al *Commentary* § 133 5-355, 5-356 & 5-357 read with n 6 also seem to imply that the duties of an "ordinary" contract of sale included delivery of the seller's security certificate. Under the 2008 Companies regime this is affirmed in Delport *Henochsberg* § 51 214. However, this does not derogate from the principle crystallised in *Botha v Fick* 1995 (2) SA 750 (AD) at 778 that no out and out *cession* of the full underlying interest requires any documentary or other formalities.

However, regarding transfer of the security *instrument*, Deport (*Henochsberg* § 51 214) states – correctly – of the modern legal position that:

> "[a]s between the transferor and the transferee, it is the duty of the latter to obtain registration of the transfer. Section 51(6) does not require the certificate to be lodged together with the instrument of transfer but the Memorandum of Incorporation may preclude or restrict registration of transfer of a share unless the instrument of transfer lodged with the company is accompanied by the certificate of the share."

390 See Chapter 10.

perhaps total security-holdership) is thus only *one* manifestation of a deeper policy position running through both the adjectival and substantive areas of securities law.

The common thread amongst these certificate functionalities can, once again, be tied to Kleyn's observation that, in certain instances, there is an undeniable need to access economic value locked up in incorporeal things by treating them (as far as possible) as "commodities", and thus the potential objects to other rights, within property law.[391] The proprietary principle at play here is publicity of a "strength of legal position" not readily achievable in South African law as it relates to incorporeals. In order to emulate a level of legal certainty ordinarily associated with the type of publicity that, for example, physical delivery (i.e. *traditio*) effects, securities were linked to a physical thing – a certificate; however, this connection could never, due to the English law-oriented development of securities in South Africa, be strong enough to make negotiable instruments of securities. Thus certificates inhabit a legal no man's land between the former and truly intangible obligations, but do so for very sound reasons of policy and pragmatism.

This, in conjunction with the preceding analysis regarding effective factual control, seems to suggest that one of the most important roles of the security certificate is to indicate, prima facie, to a counter-party that its *possessor* in fact also has *effective factual* control over the incident or incidents at play in any given commercial transaction (see the example given at the end of this section).

Its more traditional role also needs to be briefly revisited. The authors in *Commentary 2008* appear to take the view that, due to separate nature of registered ownership and beneficial ownership, the import of s 50(4) of the Companies Act is that it serves as prima facie evidence of *instrument*-holdership as distinct from *asset*-holdership:[392]

> "the preferred view is that in South Africa the registered holder is vested with the rights attaching to registered title (which appears to be a proprietary interest but not ownership). The fact that the registered holder may not be the beneficial owner provides the basis for a reasonable argument that, at least in regard to certificated securities, s 50(4) is best read as not giving rise to any presumption that the registered holder is the beneficial owner of securities, as ownership should not be regarded as a fact reflected in a securities register (even though the registered holder can be the owner and the register can constitute evidence in support of an assertion of ownership).
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> …
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> As was the case under the 1973 Act, a certificate is *prima facie* evidence of registered title, which should not be confused with beneficial ownership. This is also implied from s 51(1), which describes a certificate

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391 Kleyn (1993) *De Jure* 7 – the "*wesenlike behoefte in die praktyk bestaan het na die onstoflike as kommoditeit binne die sakereg, of dan in moderne terminolgie, die funksionering van regte as objekte in die saaklike reg…".*

392 Yeats et al *Commentary 2008* 2-782 & 2-787, respectively.

as evidencing certificated securities and, from this, it is apparent that there is no intention to change the law in this regard."

This position is supported by this work, though it must be noted that the presumption of *security*-holdership may also be supported by physical certificate holdership, should the factual matrix in question justify such a presumption.[393] Though there is some uncertainty in terms of the full extent of the presumption, it is submitted that the appropriate approach would be a variable one, supported in its application by the particular factual matrix at issue.

Such an understanding of the role of the security certificate completes the view of the factual features of security-holdership. The evidentiary, publicity, and reliance-strengthening functions of the certificate are all elements of this deeper role as factual and physical indicator of control, allowing the law better to make factual determinations (especially in the proprietary sphere), without losing the essentially obligationary character of the securities construct in South African jurisprudence.

The full range of legal functionality of the security certificate, and its usefulness, is relatively under-appreciated, especially in the establishment and publicising of real rights (i.e. interests in securities).

Consider the following example: there is a certificated security, "X", of which the instrument-holder is A, and the asset-holder is B. B subsequently grants to C a usufructary right, through a limited cession, to the income stream associated with that security. The limited cession occurs, in terms of the ordinary rules of cession, in a form-free manner. However, to establish C's control over the income stream (and thereby complete the real agreement), B must modify the scheme of agency between her and A, providing *control over A* to C in so far as the security's income stream is concerned. In order to publicise the legal position of this interest-holder, B may hand over the security certificate (in A's name) to C, making it commercially far more difficult (but of course never impossible) for either A or B to unlawfully provide a subsequent *bona* or *male fide* third party that same right.

Should B then decide to pledge the remainder of the underlying interest to D, another modification of the scheme of agency is required. This could be achieved by having D replace A as instrument-holder, in which case D will be informed that the new certificate must be handed over to C, and will also inherit the duties toward C. But it could also be achieved by having C hand over the existing security certificate to D directly. In either scenario, *knowledge* on the part of A, B, C and D of one

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393 As similarly noted in Yeats et al *Commentary 2008* 2-787 – 2-788, noting specifically that "[s]uch an interpretation would be predicated on an underlying presumption that, in the absence of evidence to the contrary, there has been no separation of registered title and beneficial ownership….[so that it] remains to be seen how our courts will interpret the evidentiary presumption."

another's rights and duties rests on what has been done with the certificate, and if the above steps have been taken, such knowledge would be difficult to dispute.

The potential of unlawful alienation is also elegantly limited. Should A, or D as the case may be, wish to unlawfully sell the security *in toto* to a third party by using her instrument-holdership to create the impression of *security*-holdership, the question of who has the certificate (and why) would need to be answered. Should C wish to alienate the security, the question of whose name (and why not C's name) is on the certificate will have to be answered. Should A wish to grant an identical second usufruct, the co-operation of the instrument-holder (who would already have knowledge of the first usufructary) would be required, making this also difficult.

This example shows that even in a very complex factual matrix of various cessions, agency, and a resultant constellation of different interests in security X, a sound understanding of effective factual control coupled with the appropriate role of the security certificate has great legal value.

CHAPTER 5

5 Adaptations in respect of uncertificated securities

The purpose of this chapter is to acknowledge and examine the necessary adjustments to the legal model of (debt) securities, presented in the previous chapter, that is required due to the statutory legal arrangements for securities' taking *uncertificated* form.

The first section critically evaluates key elements of the legislative process which first regulated immobilisation and then enabled dematerialisation, and the influence of this statutory legacy to better understand certain relevant and currently applicable sections of the Companies Act[1] and the Financial Markets Act ("FMA").[2] Predominantly, it focuses on the meaning of "deposit", the structure of the system for the custody and administration of uncertificated securities, and the nature of "ownership" (or rather holdership) of uncertificated securities.

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1 71 of 2008.

2 19 of 2012.

The second section deals with the concept of "interests in uncertificated securities" as found in the international securities environment, and its consequences for the contemporary domestic legislative scheme.

5 1 Understanding the modern statutory framework for uncertificated securities

The first aim of this section is to demonstrate, through analysis of the legislation and prevailing commentary, that the provisions of the FMA which relate to the nature of uncertificated securities and their holdership within the custodial system are largely a product of the development of the academic views and domestic legislation preceding it. Specifically, it argues that there is in the wording of many of these provisions a historical path dependence, both terminologically and conceptually, which makes the precise meaning and operation of these provisions in the Act in the current environment somewhat difficult.

Understanding this path dependence enables a better reading of the Act – "statutory evolution is important for the interpretation of the FMA, as the provisions relevant to the custodial arrangements governing uncertificated securities under the FMA are in many instances a mutation of the original provisions in the Safe Deposit of Securities Act."[3] This in turn facilitates a number of useful conclusions drawn regarding the nature of uncertificated securities and their holdership, which will emerge from the discussion.

It is of some importance to state at the outset that this section will outline what is submitted to be the most coherent and systemically logical manner in which the FMA *should* be read. This may to some extent diverge from the manner in which it is currently read in practice.[4] The FMA in its current form "[is not] a model of clarity and consistency",[5] and it is in the nature of the practical commercial environment to make good use of such uncertainty. This work prioritises theoretical defensibility and holistic consistency. Nonetheless, it is hoped that what is proposed here at least incrementally improves the collective understanding of this critical piece of financial legislation.

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3 JL Yeats, R de la Harpe, R Jooste, H Stoop, R Cassim, J Seligmann, L Kent, R Bradstreet, RC Williams, MF Cassim, E Swanepoel, FHI Cassim & K Jarvis (2018) *Commentary on the Companies Act of 2008* 2-520.

4 However, the analysis does strive for a measure of balance, as per I Meissner *Securities within the realm of private law: a theoretical and practical analysis of the legal nature of shares* LLD thesis University of Stellenbosch (2019) 224, in that:

> "[p]ragmatism and functionality drive markets. Conceptual and doctrinal foundations, on the other hand, are the domain of the law. The sphere of shares and securities is shaped by a constant compromise between functionality, doctrine and conceptual soundness."

5 Yeats et al *Commentary 2008* 2-614.

Much of the background necessary to analyse the evolution of the relevant provisions of the Custody and Administration of Securities Act,[6] the Companies Second Amendment Act[7] (introducing s 91A to the Companies Act of 1973), the Securities Services Act ("SSA"),[8] and finally the currently operative Companies Act and FMA, was already covered in § 3 2 1 2 and § 3 2 of Chapter 3. It is not the aim of this section to repeat this. To explore the manner in which certain fundamental provisions in Chapter IV of the FMA contain "inherited" language, and the consequences in terms of the nature of the *uncertificated* security asset and instrument as they exist today, very specific elements of its history, as well as the international parlance which influenced its language, must be discussed, with the work of Chapter 3 as background.

In 1984, a comprehensive and insightful comparative analysis of the solutions to the "paper crunch" which led to immobilisation- and dematerialisation-based systems in various jurisdictions was published by FR Malan. That work then goes on to outline a potential way forward that could be adopted domestically ("South African perspectives"). A few of observations and suggestions made therein are critical for what follows, and so are reproduced at some length here:[9]

> "South African securities certificates are not negotiable instruments. Nor, it is submitted, is there any need to convert them into negotiable instruments…The movement should rather be towards the elimination of the securities certificate where the securities are held by a depository. *The choice is not between "dematerialization" and "immobilization*". The need is rather to consolidate the vast holdings of banks and brokers into a central securities depository or*, more correctly put, a central securities nominee company*, and to provide for the transfer of securities between participants and the creation of security interests in securities, by means of book entry.
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> …
>
> The holdings of a central securities depository need not be evidenced by securities certificates – whether block or other certificates, and an open "uncertificated" current securities account can be opened for it in the register of every issuer of listed securities. It will be possible to make new issues of securities directly to a central securities depository and to provide for their issue in this manner in the prospectus offering them to the public.
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> …

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6 85 of 1992, which was entitled the "Safe Deposit of Securities Act" until a 1998 amendment. This will be discussed in the following section.

7 60 of 1998.

8 36 of 2004.

9 FR Malan *Collective Securities Depositories and the Transfer of Securities* (1984) 230-236 [own emphasis]. See also Yeats et al *Commentary 2008* 2-513 – 2-536; FR Malan "Depositories, nominees and the uncertificated security" (1987) 9 *Modern Business Law* 73, specifically § 8 & 9; and FR Malan & MJ Oosthuizen "The safe deposit of securities" (1989) *Tydskrif vir die Suid-Afrikaanse Reg* 502.

> The creation of a collective securities depository system *requires no change in the nature of South African securities as registered securities. In fact, it will be based on current securities holding practices.*
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> …
>
> The participants in the depository are banks, brokers and other financial institutions who have re-deposited securities given to them for safe custody with the central securities depository. The securities themselves are registered in the name of the depository. Thus, the investor can exercise his rights only through his bank or broker, but the latter, not being registered as holder of the securities, must convey to the central securities depository the voting and other instructions of the investor.
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> …
>
> An investor depositing securities with a participant for safe custody must be placed, as far as possible, in the same position as if he had himself been registered as the holder of the securities. *This requires legislation* to amend present enactments*, and to define the rights of the investor to securities held in collective deposit.*
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> …
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> What then are the rights of the investor to the body of securities of that kind held by the participant or the central securities depository *as fungibles* on his behalf and on behalf of the other investors? The interest of an investor, his collective depositary share, cannot be described in terms of ownership of the tangible certificates because the certificates of securities held by the central securities depository will be destroyed, and the certificate is, in any event, not strictly a negotiable instrument determining who is holder of the securities themselves. *Ownership or co-ownership of the tangible does not decide the question who is entitled to the incorporeal rights. It is submitted that the holders of the securities deposited with a participant are co-holders of the whole body of securities of the same kind held by the participant, and that they are also co-holders of the securities re-deposited with the central depository, even if they are deposited on the account and in name of the participant. The totality of the rights of the investor is his collective deposit share.* This he cedes or transfers when deliveries are made and "pledges" when he applies his holdings as security."

In the above there appears to be an early appreciation, domestically, of three key elements needed for the modern centralised and uncertificated system.

First, the registered nature of South African securities already allowed, theoretically, for the use of a central custodial *nominee* (rather than, strictly, depository) functionary or set of functionaries necessary to do away with paper-based holding and transfer.

Second, the concepts of "immobilisation" (not technically required, or possible, for registered securities) and "dematerialisation" are in fact less important than the relevant custodial and electronic recordkeeping arrangements needed within a registered securities-dominated jurisdiction whose private law is fundamentally Civilian. What is truly important is the manner in which the system arrived at the *consolidated holding (and transfer) of uncertificated securities* via a central functionary or set of functionaries (specifically electronic and consolidated instrument-holdership). In terms of the unique development of the current system, and the peculiar confluence of Continentally-influenced immobilisation and ultimate dematerialisation in South Africa, it is noted that:[10]

> "[p]ursuant to these investigations [regarding the establishment of STRATE], it was decided that it would be beneficial to provide for listed companies to dispense with physical certificates and transfer forms and permit the holding and transfer of securities to be recorded electronically only. To ensure that the securities registers would be properly maintained and reliable, *it was decided that the immobilisation model* should be used with the securities registers administered by a regulated central securities depository and its participants for the various issuing companies. The 'electronically evidenced' securities that would be subject to this new arrangement were referred to as 'uncertificated' securities in order to distinguish them from the certificated securities."

Third is the insight that co-holdership of the underlying interests of securities appears to be a natural, inevitable legal consequence of centrally consolidated, account-based and *collective* uncertificated instrument-holdership, due to the (quasi-) fungibility of securities of the same kind held in a particular account by a central, custodial instrument-holder or group of instrument-holders. These holders were the depository participants where re-"deposit" did not occur, and the central securities depositary where re-"deposit" did occur. This has important consequences for asset-holdership in terms of uncertificated securities under the FMA.

Yet until the passage of the Companies Second Amendment Act, the Safe Deposit of Securities Act did not fully implement the outcome of these insights. Instead, it opted only slightly to modify, regulate and clarify the then-status quo of (ostensibly) immobilising registered *certificated* securities through (an equally ostensible) deposit of "listed securities, financial instruments, and other securities approved by the Registrar of Financial Markets"[11] at a central custodial institution. In doing so, the Safe Deposit of Securities Act actually enabled two kinds of "deposit" – deposit with already prominent custodial institutions such as banks and brokers as participants, and thereafter a legislatively enabled deposit (or re-deposit) with a central securities custodian (also unfortunately termed a depository).[12] The act also formally legislated for the concept of "*co-ownership*" of the fungible bulk of securities "of the same kind" deposited in any single account maintained by a participating institution or the central depository.

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10 Yeats et al *Commentary 2008* 2-537 – 5-539 [own emphasis].

11 M Vermaas "Die wet op die veilige bewaring van effekte" (1996) 8 *South African Mercantile Law Journal* 190 195.

12 Vermaas (1996) *SA Merc LJ* 194-195.

The legislative developments which followed, and the associated relevant authoritative views, are adequately discussed in § 3 2 1 2, and § 3 2 of Chapter 3 of this work.[13] This discussion has a more specific focus, namely: (1) to show a persistent terminological and conceptual path dependence observable in relation to the relevant provisions in s 1 and Chapter IV of the FMA, and (2) to draw upon these insights to better understand the underlying legal position applicable to uncertificated security-holdership at present. This will be broken up into three discussions: (1) deposit; (2) the structure of the uncertificated custodial system; and (3) the impact of the "co-ownership" construct.

5 1 1 Deposit

It is important (for this and the following two discussions) that, historically, instrument-holdership seems to have been (and perhaps still is) regarded not as a true form of holdership, but rather more an administrative, agency-based, *arrangement* between beneficial owner, registered owner and issuer, necessitated by the fact that issuers are, as a point of departure, not obligated to look behind their securities register. Malan (whose influence on subsequent developments makes this significant) seems to place particular emphasis, in discussing both government and company securities, on register entry and certification as *prima facie evidence of true "ownership"*.[14] The duty of an issuer not to "see to the execution of a trust", whether for instance in terms of s 104 of the 1973 Companies Act or by similar arrangement in the issue of government securities, enabled the nominee role in South African law. This in turn allowed "considerable progress…towards the immobilisation of securities through the use of nominees and global certificates".[15]

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13 Pertinent authorities on dematerialisation and uncertificated securities (and its development), upon which this discussion draws, generally, are: Malan *Collective Securities Depositories*; FR Malan "Depositories, nominees and the uncertificated security" (1987) 9 *Modern Business Law* 73; FR Malan & MJ Oosthuizen "The safe deposit of securities" (1989) *Tydskrif vir die Suid-Afrikaanse Reg* 502; M Vermaas *Aspekte van die Dematerialisasie van Genoteerde Aandele in die Suid-Afrikaanse Reg* LLD thesis UNISA (1995); M Vermaas "Die wet op die veilige bewaring van effekte" (1996) 8 *SA Merc LJ* 190; M Vermaas "Dematerialisasie van die Genoteerde Aaandeel in die Suid-Afrikaasne Reg" (1997) 9 *SA Merc LJ* 42 [Part 1] & 171 [Part 2]; M Vermaas "Dematerialisation of listed securities: a synopsis of the Companies Second Amendment Act 60 of 1998" (1998) 10 *SA Merc LJ* 336; K Van der Linde & S Luiz "Aspects of the cross-listing of securities" (2009) 21 *South African Mercantile Law Journal* 631; M Vermaas "The reform of the law of uncertificated securities in South African company law" (2010) *Acta Juridica* 87; MS Blackman, RD Jooste, GK Everingham, JL Yeats, FHI Cassim & R de la Harpe *Commentary on the Companies Act: Volume 1* (RD 8 2011); PA Delport et al *Henochsberg 2008* § 52-55; FHI Cassim (ed) *Contemporary Company Law* (2012) 257-258; and Yeats et al *Commentary 2008 viz.* s 1, s 49, s 52 & 53.

14 Most notably see Malan *Collective Securities Depositories* throughout § 6.3, 140-153; and Vermaas (1996) *SA Merc LJ* § 3.3, 207-208.

15 Malan *Collective Securities Depositories* 137.

Immobilisation (in truth a misnomer in the context of certificated securities)[16] in South Africa was implemented by placing (whether individually or by global certificate) a custodial institution on the issuer's securities register. This was a process typically referred to as "deposit for custody and administration". It evolved from an earlier, emergent practice whereby investors would keep certificates in own name, but physically deposit these certificates with custodial institutions such as banks and brokers for safe keeping.

These institutions began to facilitate dealings between investors and issuers, which in turn naturally led to own (i.e. investor's) name certificates and register entries being replaced by entries and certificates reflecting the custodial institution, or a specialised subsidiary, as registered holder ('nominee'). Finally, in the certificated era, it became easier for these institutions to: (1) make use of single issuers' register entries and corresponding "global" securities certificates, and (2) reflect their underlying investors' holdings and cessions of the securities between clients in accounts kept by them internally.

Through these developments, the acts of *taking custody* of own name certificates and the *administration* of issuer-investor relations evolved into "deposit" as a malapropism for registered transfer to an intermediary institution mandated to act as nominee for an individual investor or a collective body of investors. This begins to make sense of the wording of the FMA, and specifically of the odd interrelation between the definitions of "deposit" and "entry".

Given the above, it is fairly clear that so-called deposit did not just "include", but in fact overwhelmingly *was*, making the custodial institution instrument-holder through "entry", with entry referring to both entry on the issuer's register and the concomitant destruction and issue of the relevant certificates.[17]

This brings one to the uncertificated era. As fully discussed in Chapter 3, the passage of the Second Companies Amendment Act, which inter alia inserted s 91A into the Companies Act of 1973, as well as further amendments primarily to the Custody and Administration of Securities Act (the amended title of the Safe Deposit of Securities Act), enabled the dematerialisation of the security *certificate*, enabling *uncertificated* holdership.

It is not altogether surprising, in light of the system of putative immobilisation already in place, that the introduction of uncertificated securities changes very little in terms of the meaning of "deposit".

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16 The *true* immobilisation of the rarer species of bearer securities was possible under this system, but in such cases the position should be seen as follows: the investor loses ownership of the security and acquires a personal right, as evidenced by the depository institution's internal accounts or ledgers, which is the economic equivalent of the security itself – i.e. an "interest in a security" as per internationally used terminology. See § 5 2 below for a full discussion on this issue. See also Meissner (2019) 230.

17 See also Meissner (2019) 227-228.

The only true difference is this: instead of the issuer destroying the investor's own name certificate, issuing a new certificate (or amending, if necessary, a global one) in the name of the custodial institution or its nominee, and making a corresponding change to the relevant securities register, the *depository institutions and central securities depository* became empowered to maintain uncertificated securities registers, with the status of issuer's register. As a result they were able to make entries in that register to reflect the securities as uncertificated, upon which the certificate or certificates would be destroyed, and those entries would be seen as those of the issuer.

With that as background, the meaning of "deposit" and its relationship to "entry" can be made clearer. For easier comparison, the legislative evolution leading to the FMA is presented in tabular format:

Deposit & Entry		
Custody and Administration of Securities Act	*Securities Services Act*	*Financial Markets Act*
Section 1 – "**deposit**" means a deposit of securities for custody and administration and includes a deposit by means of an entry in a securities account or a central securities account	Section 29 – "**deposit**" means a deposit of securities and includes a deposit by means of an entry in a securities account or a central securities account	Section 1 – "**deposit**" means a deposit of securities, and includes a deposit by means of an entry in a securities account or a central securities account
Section 1 – "**entry**" includes an electronic recording of any deposit, withdrawal, transfer, attachment, pledge, cession in securitatem debiti or other transaction in respect of securities	Section 29 – "**entry**" includes an electronic recording of any deposit, withdrawal, transfer, attachment, pledge, cession to secure a debt or other transaction in respect of securities	Section 1 – "**entry**" means an electronic recording of any issuance, deposit, withdrawal, transfer, attachment, pledge, cession in securitatem debiti or other instruction in respect of securities or an interest in securities

The structure of the system that preceded dematerialisation, and its development, allows one to posit that "deposit" under the FMA should be read (though not without some effort) to cover five different possible events.

First is the *physical deposit* of bearer securities. Due to their scarcity in South Africa, this is likely to be directed primarily at the deposit of foreign bearer securities, in order to create a secondary, "representative" uncertificated security fit for use in the domestic exchange environment – see § 5 2 below for the manner in which these securities are integrated into the South African environment. In short, this deposit does not imply a corresponding "entry", but it does require a *subsequent* entry recording the *issuance* of the secondary, representative security. This is because a physical deposit of bearer securities will, necessarily, cause ownership of these negotiable instruments to pass to the depositary institution, making holdership through entry, and transfer by debiting and crediting, of that security itself impossible within the current system.

Second, it may refer to the dematerialisation ("substitution" or "conversion")[18] of bearer or certificated securities into uncertificated securities by means of *entry* read as meaning the destruction of the relevant physical document and electronic recording of a fictional "deposit" in the (historically informed) sense discussed above – i.e. deposit as registered transfer to an intermediary institution mandated to act as nominee.[19]

Third, deposit is read as entry of a *transfer* of already uncertificated instrument-holdership from one custodial functionary to another – i.e. the transfer of uncertificated security instruments between different securities accounts maintained by a Central Securities Depository ("CSD") or Central Securities Depository Participant ("CSDP"), and possibly but improbably (see the following section) authorised users and nominees.

Fourth, but somewhat contentiously, it is the *physical* deposit of security *certificates* and the corresponding entry into the *issuer's* register of the custodial, depository institution (i.e. a CSD, CSDP, or authorised user of an exchange) as the nominee of the asset-holder – i.e. immobilisation as it was in the past, which still seems possible.[20]

Fifth, could the definition also include "deposit" as an entry recording *issuance* of uncertificated securities *ab initio*?

It is unclear whether issuers were able, under the systems of immobilisation and early dematerialisation, to issue securities in a manner where the intermediary institutions were registered holders, as nominees of the underlying subscribers, *ab initio.* From the analysis quoted in the previous section, Malan appears to have at least supported the practice, but whether it constitutes a deposit is less clear.

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18 "Conversion" is used in s 33 of the FMA, "substitution" is the term used in s 54 of the Companies Act, and "conversion" is, again, the term used in Regulation 33 of the *Companies Regulations, 2011* GN R 351 in *GG* 34239 of 26-04-2011. The terms should, as a point of departure but with some caution, be read as synonymous; see also Yeats et al *Commentary 2008* 2-651 – 2-655.

19 On this, Yeats et al *Commentary 2008* 2-521 note, and caution, as follows:

> "When there is a substitution of certificated securities for uncertificated securities, the FMA contemplates the relevant securities being 'deposited' in the relevant securities account and ultimately they must be 'deposited' with the relevant central securities depository and 'held' in the central securities account. This is a unique statutory arrangement. The use of the terms 'deposit' and 'hold' appear not to have their 'ordinary' common-law meanings and need to be considered in the context of the related statutory depository arrangement. This is a fictional statutory deposit, because securities, being intangible, cannot be (at least physically) deposited or possessed…The 'dematerialisation' process in terms of which certificated securities are substituted by uncertificated securities can be viewed simplistically as an exchange of the certificate representing the certificated securities for an electronic entry in the uncertificated securities register maintained by the relevant central securities depository or participant, which entry evidences registered title to the uncertificated securities. This simplistic view, however, belies the substantive complexities and consequences. When there is a substitution of certificated securities for uncertificated securities, the FMA contemplates the relevant securities being 'deposited' in the relevant securities account and ultimately they must be 'deposited' with the relevant central securities depository and 'held' in the central securities account."

20 See Yeats et al *Commentary 2008* 2-519 – "Immobilisation continues to be permitted under the FMA but most uncertificated securities under the Act are fully dematerialised." This will be further discussed in § 5 1 3 below.

The issue of securities in a manner where an intermediary depository institution is the primary market acquiring instrument-holder is familiar in the modern environment as the de facto manner in which listed securities are issued. Explicit recognition of the practice is first encountered in s 91A(10) of the Companies Act of 1973,[21] but the Custody and Administration of Securities Act is silent on the matter, and more substantive provisions regarding the matter were only effected through s 37 of the SSA.

Nonetheless it seems uncontentious, looking at the various definitions across the Custody and Administration of Securities Act and as in s 91A of the 1973 Companies Act, that deposit includes entry, and entry therefore could have been read to include entry for the purposes of issuance. On balance it is most likely that this is how the term was read.[22]

It does not, however, conversely follow that entry for the purposes of issuance necessarily constitutes a deposit under the current regime.

Both s 37(2) of the SSA and its successor in s 33 of the FMA, but even more so the addition of "issuance" *alongside* "deposit" in the definition of "entry" in the FMA (as well as in the wording of s 46), all seem to point to the view that the issue of securities in uncertificated form does not constitute a deposit under the current framework, and is indeed a different kind of entry.

Yet the definition of "central securities account", and the entire "deposit"-centric scheme of notable provisions such as s 20, s 22, s 32, s 37, and s 44 currently support the contrary view. It is submitted that the aforementioned definition and sections (specifically those relating to CSDs, CSDPs and authorised users) cannot properly function unless "deposit" includes issuance, because otherwise their effect would only be in respect of securities that have subsequently been dematerialised or immobilised (i.e. that are already in the system), and not those *issued* in uncertificated form.

It is therefore submitted that the circularity, inconsistency, and consequent absurdity of the definitional scheme of *deposit* vis-à-vis *entry* must be resolved as follows. *Deposit in the wider scheme of the FMA is a species of entry*, and one that includes "issuance" and "transfer" in addition to the other three, more natural, uses described above. This is not an ideal solution, and legislative intervention to rectify this issue is strongly advocated.

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21 Which reads:

> "(10) (a) Subject to subparagraph (b), when any new offer of securities is made by a company, the offeree may elect whether all or any part of the securities offered to him, her or it must be issued in certificated or uncertificated form.
>
> (b) A company shall only issue or allot uncertificated securities to a person who is already a client of a participant or for whom a participant has agreed to act."

22 Blackman et al *Commentary* at 5-215, for example, suggest reading entry by transfer, rather than deposit, to include "acquisition…by way of subscription". The reading of deposit provided here resolves this, somewhat forced, reading in the context of the FMA. This should also be compared with Yeats et al *Commentary 2008* 2-521.

Conversely, the various meanings (and therefore functions) of the definition of "entry" that are *not* a deposit should be clear from the above as comprising "withdrawal…attachment, pledge, cession in securitatem debiti or other instruction in respect of securities or an interest in securities". This wide scope afforded for the other possible functions of entry, also evident throughout the legislative iterations, will become relevant in the final section of Chapter 8, when dealing with limited real interests in securities.

The truly problematic issue regarding "entry" in relation to "deposit" is the question *with whom* securities may be so deposited. It is specifically problematic because not all actors that are empowered to maintain an uncertificated *securities account* are also empowered to maintain the uncertificated *securities register*. This requires an analysis of the custodial system envisaged by the FMA, specifically the structure of the uncertificated securities register and various downstream accounts and records that lie between the asset- and instrument-holders.

5 1 2 The custodial and administrative system: the structure of the uncertificated securities register, securities accounts, and the traceability of security instrument to security asset

The second key issue in analysing the nature of uncertificated securities is the influence of the development of securities accounts, participants, and "depositories" on the custodial system implemented by the FMA. Along with the meaning of "deposit", the structure of the custodial system is a fundamental building block in understanding the proprietary dispensation which governs asset-holdership under the FMA (the topic of the next section).

A tabular representation of the legislative evolution to provide the necessary background for the subsequent discussion is as follows:

Depository / Repository		
Custody and Administration of Securities Act	*Securities Services Act*	*Financial Markets Act*
Section 1 – "**central securities depository**" means a public company incorporated in terms of the Companies Act, 1973 (Act No. 61 of 1973), and registered as a central securities depository in terms of this Act; "**central securities repository**" means a collection of securities of	Section 1 - "**central securities depository**" means a person who is licensed as a central securities depository under section 32; … Section 29 – "**central securities repository**" means a collection of securities of the same kind held by a central securities depository;	Section 1 – "**central securities depository**" means a person who constitutes, maintains and provides an infrastructure for holding uncertificated securities which enables the making of entries in respect of uncertificated securities, and which infrastructure includes a securities settlement system

the same kind as contemplated in section 11; … "**depositary institution**" means a person or category of persons authorized by the Registrar to hold and administer securities or an interest in securities for the purposes of this Act; … "**securities repository**" means a collection of securities of the same kind as contemplated in section 3.	… "**securities repository**" means a collection of securities of the same kind held by a participant	
Securities accounts		
Custody and Administration of Securities Act	*Securities Services Act*	*Financial Markets Act*
Section 1 – "**central securities account**" means an account kept by a central securities depository for a participant and reflecting the number or nominal value of securities of each kind and all entries made in such account	Section 29 – "**central securities account**" means an account kept by a central securities depository for a participant and reflecting the number or nominal value of securities of each kind deposited and all entries made in respect of such securities	Section 1 – "**central securities account**" means an account that reflects the number or nominal value of securities of each kind deposited and all entries made in respect of such securities, held by a licensed central securities depository for a participant or external central securities depository in the name of— (a) a participant; (b) an external central securities depository; or (c) any other persons as determined in the depository rules
Section 1 – "**securities account**" means an account kept by or on behalf of a depositary institution for a client and reflecting the number or nominal value of securities of each kind deposited and all entries made in respect of such securities relating to such client	Section 29 – "**securities account**" means an account kept by or on behalf of a participant for a client and reflecting the number or nominal value of securities of each kind deposited and all entries made in respect of such securities	Section 1 – "**securities account**" means an account kept by— (a) a participant or an authorised user for its own account or for a client; or (b) a nominee for a person for whom it acts as a nominee, which reflects the number or nominal value of securities of each kind held for its own account or on behalf of that client or person, as the case may be, and all entries made in respect of such securities

5 1 2 1 "Held" and "hold": distinguishing the custodial and administrative functions

Whilst there is some overlap, the development of the system of accounts that reflect holdings of uncertificated securities can be divided into three iterations (most of which is dealt with in Chapter 3, § 3 2 1 2 and § 3 2). The first two will be summarised very briefly and simplistically, after which the current system will be discussed at greater length.

In the first iteration (pre- and statutory immobilisation), participating "depositary institutions" (mainly banks and brokers) maintained accounts for individual investors or omnibus accounts (through global register entry and certificates) for multiple investors who had deposited certificated securities with these custodial institutions. These participating depositories could, but did not have to, re-deposit their holdings at a central securities depository. The issuers' securities registers retained their traditional function, reflecting these depositories (and later depository participants) as registered holders of the securities.

This system was chiefly characterised by the fact that *issuers* maintained the securities registers reflecting instrument-holdership, and *depositories* maintained accounts containing the particulars of the holder on whose behalf they held instrument-holdership (i.e. asset-holders, or further downstream intermediaries on mandate from asset-holders). Later in this iteration central depositories arose, and these earlier depositories became depository participants within the chain of intermediation, maintaining similar "sub-accounts".

In the second iteration (early dematerialisation), central depositories and licensed depository participants, in the modern sense, took over both the roles of: (1) these depositary institutions (such as banks or brokers, who in turn became their clients), and (2) the issuers, through the introduction of their maintaining uncertificated securities registers and "subregisters". The central depository maintained a central uncertificated securities register where securities could be re-deposited by participants. In terms of this tiered structure, participants' subregisters and central depositories' registers required periodic reconciliation (as mandated by the statutory provisions enabling the system), together constituting the overall uncertificated securities register.

Under this system, depositories and depository participants in the system maintained the (uncertificated) securities register through central and participant securities *accounts* reflecting: (1) *instrument*-holdership by entry, and (2) the particulars of the downstream client (participant, further intermediary or asset-holder) *for whom* the account is being kept.[23]

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[23] See § 5 1 2 3 below, and specifically the discussion of Blackman et al *Commentary* 5-220-2, 5-220-3, and 5-221 ("*Subregisters*").

Participants' clients, and any intermediaries further downstream of those clients, maintained unregulated records[24] reflecting the particulars of *their* clients in a manner that should have enabled evidentiary traceability all the way down to end-of-chain asset-holdership in more complex factual patterns of holding and intermediation.

In respect of the third (current) iteration, the key elements are a shift away from the tiered uncertificated securities register and the addition of the maintenance of securities accounts and recordkeeping duties for further downstream actors identified in the FMA (i.e. authorised users and nominees).

In the "*custody* and *administration*" of securities, the meaning of the terms "held" and "hold" in certain sections of the FMA cause significant interpretive problems. Specifically, the Act makes indiscriminate use of the terms for two functionally separate and distinguishable acts, namely: (1) maintaining securities accounts (that could, in light of the various meanings of deposit, be called the *custodial* function), and (2) acting as instrument-holder of uncertificated securities (that could be called the *administrative* function).[25]

The issue is another that arises directly from the terminological and conceptual path dependence in the development of the relevant legislation.

Under a true system of immobilisation (such as the one developed in Germany),[26] the terms held and hold are perfectly apt. The bearer securities physically deposited are held for both custody and administration with depository institutions as true owners of those securities, and end-of-chain investors gain only an "interest in securities" evidenced by ledger entry as understood in the more international sense discussed in § 5 2 below.

Under the first iteration of the South African custodial system, the term was also apt. The custody and administration of immobilised securities entailed that the custodial (nominally depository) institutions (such as banks and brokers) maintained securities accounts (by book entry) *and* served administratively as instrument-holders using individual and global certificates. Thus the then-*concurrent* custodial and the administrative functions were well described by the terms "held" and "hold".[27]

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24 Unregulated by the enabling companies and uncertificated securities legislation, though other kinds of financial regulation is not precluded by this characterisation.

25 A good example being the discussion in § 9 2 1 of Chapter 9 below regarding the differences in language between s 38 and s 39 of the FMA.

26 See § 3 2 1 of Chapter 3.

27 See § 3 2 1 2 and § 3 2 2 of Chapter 3.

Between the first and the second iteration, participating custodial institutions began to make use of nominees and potentially other third parties. This is the beginning of a divergence between the custodial function of maintaining securities accounts and the administrative function of instrument-holdership, though differentiating these functions in this manner is not a perfect description of the true state of affairs (most importantly because the actual administration was no doubt still mainly performed by custodial institutions *via* their nominees on behalf of clients and ultimately the asset-holders themselves).[28]

Issues related to the "holding" of securities in terms of the custodial function (i.e. maintaining securities accounts) and the administrative function (i.e. instrument-holdership) by different system actors begin to emerge under dematerialisation. At this stage in the system's development, the custodial function expanded to entail maintenance of the uncertificated securities *register* itself (until then the purview of the issuers themselves).

Consider the definitions of the "central securities repository" and "securities repository" in s 29 of the SSA – the use of "held" does not properly distinguish between these two functions. The definition of "nominee" (in s 1 of the SSA) reads "…a person that acts as the registered holder of securities or an interest in securities on behalf of other persons", ostensibly limiting those functionaries to instrument-holdership, and therefore the administrative function only.

Yet looking at the definition of "securities accounts", carried over from the Custody and Administration of Securities Act to the SSA, securities accounts could be "kept…on behalf of" participants, while only the accounts of CSDs and CSDPs constituted the uncertificated register. Therefore, for example, if a securities account was maintained by a third party "on behalf of" a CSDP, and the instrument-holder of a particular security was a broker's nominee, what is "held" by that CSDP in the securities repository?

On the one hand, because the definition of "securities account" retained the phrase "deposited and all entries made", the securities accounts of the third party (as agent in terms of an outsourcing agreement) could be regarded *as* those of the participant. Therefore deposit and entry would still constitute register entry, so that the participant or its agent at least held the securities in the repository in terms of the custodial function.[29] The broker's nominee would still have held the securities in terms of the administrative function. In terms of this view the third party agent would merely have performed the administrative function of maintaining the register, and would not hold

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[28] See § 3 2 2 and 3 2 3 of Chapter 3.

[29] One should argue, though it stretches the definition of "nominee", that third party securities account keepers could have – and most likely did – include nominee entities acting in such a capacity as administrative *agents* for participants and depositories (see for instance Blackman et al *Commentary* 5-222 – 5-226-2).

securities in terms of the administrative function (i.e. with no effect on instrument-holdership by the relevant nominee).

However, on the other hand, it could also be read to mean that until the third party re-deposits such securities held by the broker's nominee (in terms of the administrative function) into the account of the CSDP, those securities were not formally reflected in the securities *register* itself, and nothing was held by the third party in terms of the custodial function. This is neither a desired outcome, nor one that makes much sense from interpretive and practical perspectives.

The first (i.e. agency-based) reading is the only viable one, assisted by the retention of "held" in the definition of "repository", as well as the phrase "deposited and entries made" in the definition of "securities account". The real issues surrounding the terminological path dependence inherent in the seemingly dual meaning of held, however, only truly come to the fore with the definition of "securities account" in the FMA, and its particular use of that term.

The current iteration is chiefly characterised by the fact that depositories and depository participants still maintain the (uncertificated) securities register through central and participant securities accounts determining instrument-holdership. Yet, going further than past systems, *authorised users*, *their nominees and nominees of participants* may further maintain subsidiary securities accounts (ostensibly, as per s 1, in the true sense) that reflect instrument-holdership. The records of these accounts (together with the records of *their* clients, if any) ultimately enable the traceability of asset-holdership. This is not, in principle, a radical departure from the previous iteration, but the changes to the definitions of "central securities depository", "securities account" and the removal of the "repository" concept in the custody and administration of securities provisions require a very careful reading of the FMA, and as any deeper analysis of the FMA demonstrates:[30]

> "[i]nterpreting the consequences of…'deposit' requires one to try to traverse a proprietary jungle and avoid the numerous pitfalls. One is unlikely to emerge unscathed."

The removal of the repository concept is a critical development, coming with the passage of the FMA within this third iteration, bringing with it two important developments:[31]

> "First, the co-ownership interest in s 37(1) of the FMA applies to 'securities of the same kind *held collectively* by a *participant, authorised user, nominee or external central securities depository* in a securities account or by a central securities depository in a central securities account' as opposed to having application to *all securities* of the same kind deposited with or held by 'a depositary institution or with a central securities depository'. Second, the entitlement in s 37(1) is with reference to 'securities of the same kind comprised

30 Yeats et al *Commentary 2008* 2-596.

31 Yeats et al *Commentary 2008* 2-605 [authors' emphasis].

in the securities account or central securities account, as the case may be' as opposed to 'all the securities of the same kind comprised in the *securities repository or central securities repository*'."

This makes the currently operative framework *account*- rather than repository-based. One way of interpreting this change is that the legislature has attempted to draw a distinction between securities *accounts* where securities are held collectively (i.e. pooled) and those where securities are not so held. This seems the soundest inference from the definitional scheme's (removal and) replacement of the "repository" concept in s 41 of the SSA with the phrase "held collectively" in s 37 of the FMA and elsewhere. Such a view will have a marked impact on the operation of s 37, pooling, and the entire co-ownership construct. Where relevant for the present purpose of understanding the custody and administration system (i.e. the systemic context within which such "ownership" issues emerge) it will be included as required, with a more detailed analysis of this issue in section § 5 1 3 below.

5 1 2 2 The structure of the uncertificated securities register

Regarding the uncertificated securities register:[32]

> "[w]hile the FMA contains many provisions comparable to the provisions of the repealed Securities Services Act in regard to the custody arrangements in respect of uncertificated securities, there have been a number of material changes. Most importantly, the repealed Securities Services Act and the 1973 Act provided solely for a fragmented, tiered custody structure. The Act and the FMA are more flexible and provide for the possibility of a more direct and transparent system; in particular they facilitate a model where investors can hold securities directly in the central securities account with such entries forming part of the uncertificated securities register…While in relation to equity and bond securities Strate has adopted a hybrid model, it remains for the greater part a fragmented, tiered custody structure, even though it has introduced the possibility of uncertificated securities being recorded directly in its central securities register by way of what it refers to as a 'segregated depository account' which can be done by way of 'own-name' registration or in the name of an approved nominee. Strate's model in regard to money market securities is better in that the securities are held in what it refers to as a 'securities ownership register' in the central securities account. While the apparent intention is to facilitate direct 'own-name 'registration of the 'owner' in the central securities account, this is somewhat undermined by Strate's still permitting foreign approved nominees to be registered in the 'securities ownership register'.
>
> …
>
> While the custodial arrangement is regulated, the Act and the FMA do not prescribe a particular model for the registered title and transfer of uncertificated securities, and accordingly there is a great deal of flexibility as to the model that may be adopted by central securities depositories. The structure of the uncertificated

32 Yeats et al *Commentary 2008* 2-573 – 2-574 & 2-989 – 2-991.

securities register can be direct, with the security accounts in the central securities account comprising the uncertificated securities register. Alternatively, the structure can be a tiered structure, with participants maintaining parts of the uncertificated securities register (commonly referred to as ‘subregisters’ or ‘participant registers’)…

A participant may have the following securities accounts, which can, depending on the rules of the central securities depository, comprise part of the securities register:

- in the name of a client;
- in the name of an approved nominee, which could be wholly owned by the participant; or
- in the participant’s name for the participant’s own account, but generally participants hold their securities through a separate wholly owned approved nominee account.

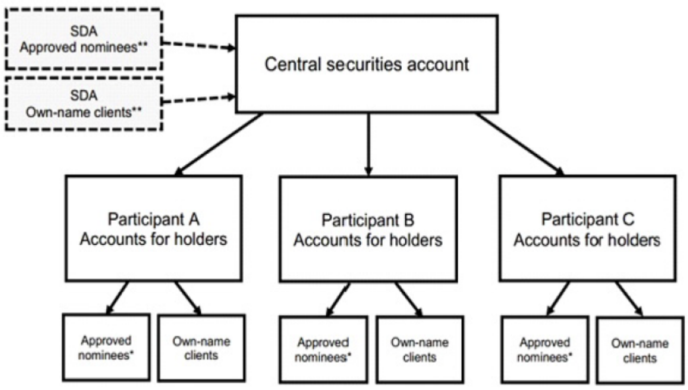
Accordingly, the investor can arrange for his uncertificated securities to be registered:

- in the investor’s name, which is referred to as ‘own-name’ registration with the investor being referred to as an ‘own-name client’; or
- through an approved nominee (technically, the approved nominee is registered as the holder in its ‘own name’ but for the purposes of these notes, the view adopted is from the investors’ perspective).

…

The following diagram explains a tiered depository structure with Strate’s SDA option:

Uncertificated securities register—tiered system



The uncertificated securities register is a collation of the approved nominee and own-name holdings.
* The nominee securities accounts detailing investor interests kept by approved nominees do not form part of the uncertificated securities register.
** Strate’s tiered equity securities structure contemplates the possibility of investors directly registering holdings in the central securities account through an SDA account. These entries are then also included in the uncertificated securities register, rendering it a hybrid. [25]

…”

Thus, under the current system,[33] uncertificated securities are notionally “held”[34] at a CSD, because as a “depository” a CSD:[35]

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[33] See also Chapter 3, § 3 2 for the fuller analysis of the legal development of dematerialisation, and the Chapter IV of the FMA (“Custody and Administration of Securities”) for the relevant statutory provisions regarding uncertificated securities.

[34] What this kind of “custody” means in terms of “ownership” is dealt with in the next section.

[35] Section 30(2)(a) of the FMA.

"must constitute, maintain and provide an infrastructure for holding uncertificated securities which enables the making of entries in respect of uncertificated securities…"

Accordingly, for any given custodial system, a CSD maintains the primary uncertificated securities register (i.e. the register of instrument-holdership) in the form of one or more[36] central securities accounts (electronic ledgers) accounting for securities of the same kind so held.

Licensed participants to the CSD (i.e. CSDPs) may also, if enabled by the depository rules, hold securities in this way – i.e. maintain subregisters in the form of *securities accounts* (also electronic ledgers) for their clients.[37] Any entries in these subregister securities accounts (e.g. a debit, credit, or other entry as per the definition) must be reconciled with the relevant CSD's primary register.

In terms of s 32(2)(a) of the FMA, "[a] participant…must, if securities are deposited with the participant, deposit them with a licenced central securities depository". This peremptory provision indicates, together with the only sensible reading of "deposit" (as in the wide sense outlined in the previous section), that all entries in securities accounts maintained by CSDPs must reflect in the central securities account, or accounts, maintained by the CSD.[38] This provision is also obviously aimed at instances where the depository rules do not enable subregisters.

Within the statutory framework (with specific reference to the definitions of "uncertificated securities register" in s 1 of both the Companies Act and the FMA, as well as s 53 of the Companies Act as incorporated by reference into the FMA for application to all uncertificated securities) *only* CSDs and CSDPs are able to maintain the uncertificated securities *register*, which may, but does not have to, include CSDP subregisters. Therefore, the only securities account entries which reflect the uncertificated securities register of each issuer of uncertificated securities are those made by CSDs and CSDPs in the accounts they maintain.

Correspondingly, the definition of "central securities account" makes it clear that securities can be *deposited* (again in the wide sense) and thereafter held directly with CSDs, such that instrument-holdership will be reflected in the central securities account.

By contrast, the definition of "securities account" contains two key changes to the previous dispensation under s 29 of the SSA (and its predecessors). First, it no longer makes reference to "deposit" – only to securities "held" and "all entries made in respect of such securities". Second, it makes provision for securities accounts "kept" by CSDPs as well as those "kept" by *authorised users*

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36 See s 30(2)(l) of the FMA, its directory "may" indicating a discretion in this regard.

37 Section 32(2)(b) & (m) of the FMA.

38 See also Meissner (2019) 229 and n 53.

and *nominees*; whereas in the past securities accounts reflecting instrument-holdership of uncertificated securities could only be kept by CSDPs or on their behalf (see s 29 of the SSA *viz.* "securities account", as discussed in the previous section).

In this regard the National Treasury's *Explanatory Memorandum to the Financial Markets Bill of 2011* provides, in § 1, that the definition was:

> "amended to include accounts held by authorised users and nominees. The accounts include both proprietary and client accounts of authorised users, participants and nominees…to extend the necessary investor protections to the whole holding chain, i.e. CSDPs, authorised users and nominee holding levels."

This raises an interesting issue. The definition of deposit in the Act states that securities may be deposited by means of "entry" in a central securities account or a securities account. This appears to indicate that securities may be deposited with any actor maintaining such an account – i.e. a CSD, CSDP, authorised user, or a nominee of any of the aforementioned. For what follows, it will be assumed that the CSD rules enable subregisters.

Due to the fact that only CSDs and CSDPs may maintain the uncertificated securities register, the definition of "securities accounts" read with the definition of "deposit" makes the function and effect of securities registers maintained by authorised users and nominees vis-à-vis (1) the uncertificated securities register, and (2) end-of-chain asset-holders, somewhat unclear.[39] Do these *non-register level securities accounts* reflect instrument-holdership or asset-holdership, or simply the particulars and holdings of the clients of these authorised users and nominees? Or some combination of the aforementioned? Further, what is the effect of deposit and entry in these accounts on the securities register? These questions are examined in the next section.

5 1 2 3 The nature and function of the CSDP securities account[40]

This discussion must begin with the nature of the *participant* securities account in terms of the second iteration (early dematerialisation enabled by s 91A of the Companies Act of 1973, and first the Custody and Administration of Securities Act and later the Securities Services Act). The nature of this ('prototypical') *register-level* securities account enables an informed discussion on the nature of register-level CSDP securities accounts, as well as the non-register level securities accounts of

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39 It is not altogether intuitively satisfying to read into the FMA two different kinds of securities accounts – ones which merely reflect the state of the register (non-register securities accounts, maintained by authorised users and all types of nominees), and ones which factually constitute the register itself (register-level securities accounts, maintained by CSDPs). Yet it is submitted that this is the most logical, consistent, and practical reading possible under its larger schema.

40 "Securities account" is used in this section specifically in contradistinction to a "*central* securities account".

authorised users and nominees (as now included by the FMA) in this current third iteration of the system.

In that context, the following observations regarding the securities accounts of participants and their relationship with the "subregister"[41] are particularly useful:[42]

> "[s] 35(e) of the Securities Services Act 2004 places a duty on the participant to record all securities, of the same class and of the same issuer company, deposited with it in a subregister…Section 35(b) of the SSA *also* requires the participant to maintain a securities account for a client in respect of securities deposited with it by the client…With regard to the information that must be reflected in the securities accounts held by participants, s 35(c) of the SSA requires that the number or nominal value of each kind of securities deposited must be reflected in the securities account. The rules of STRATE Ltd require further information to be entered into the account…[including] the name, an appropriate identification number and physical address or principal place of business of the client – *who may or may not be the owner of, and who may or may not be the member in respect of,* shares credited to the account – on whose behalf the account was opened."

Further, and most important for present purposes:[43]

> "Surprisingly the relationship between the securities account and the subregister is not clarified in s 91A of the Companies Act, Chapter IV of the SSA or the Strate Rules. Section 91A does not refer to a securities account while the STRATE rules and the SSA do not deal with the subregister.
>
> The securities accounts opened and maintained by the participant in terms of the Securities Services Act and the STRATE rules contain the information required by s 91A of the Companies Act to be reflected in the subregister…*The 'subregister' is, then, a compilation of those records in the various uncertificated securities accounts of the clients of the participants which relate to the holding of shares [here it is further noted in n 3: The securities account of the client may reflect entries of shares in various different companies deposited with the client] in the 'relevant company' by the clients in question.* Those records, and not the whole of the accounts, constitutes the 'subregister' of the company in question's register…"

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41 Defined in s 91A(1)(d) of the Companies Act 61 of 1973 as "the record of uncertificated securities administered and maintained by a participant, which forms part of the relevant company's register of members as referred to in this Act". Importantly, s 91A(3)(b) further stipulates that the subregister must contain the particulars referred to in s 105 ("Register of members") and s 133 ("Registration of transfer of shares or interests") of the Act.

There is no reference to the "subregister" in either the FMA or the Companies Act of 2008, though the discussion in § 5 1 2 2 makes it clear that the concept is both still in use and still enabled by the current legislative scheme (see also National Treasury's *Explanatory Memorandum to the Financial Markets Bill of 2011* at 32-33 on the FMA not making use of the term.

42 Blackman et al *Commentary* 5-220-2, 5-220-3, and 5-221 ("*Subregisters*") [own emphasis and paragraphing].

43 Blackman et al *Commentary* 5-221 [own emphasis].

This makes it clear that the securities account (as envisioned by the regulatory rules) had a dual function.

First, it had an upstream-facing function as *a record of instrument-holdership* – i.e. the "entries made in respect of such securities", constituting part of the "subregister",[44] looking "upstream" towards the CSD.

Second, it had a downstream-facing function as *a record of the particulars of the client* for whom the account was maintained and her holdings – i.e. "an account kept…for a client and reflecting the number or nominal value of securities of each kind deposited"),[45] looking "downstream" towards (but not necessary at) the end-of-chain investor.

A much simplified (especially regarding the particulars of the instrument-holder) representation[46] is as follows:

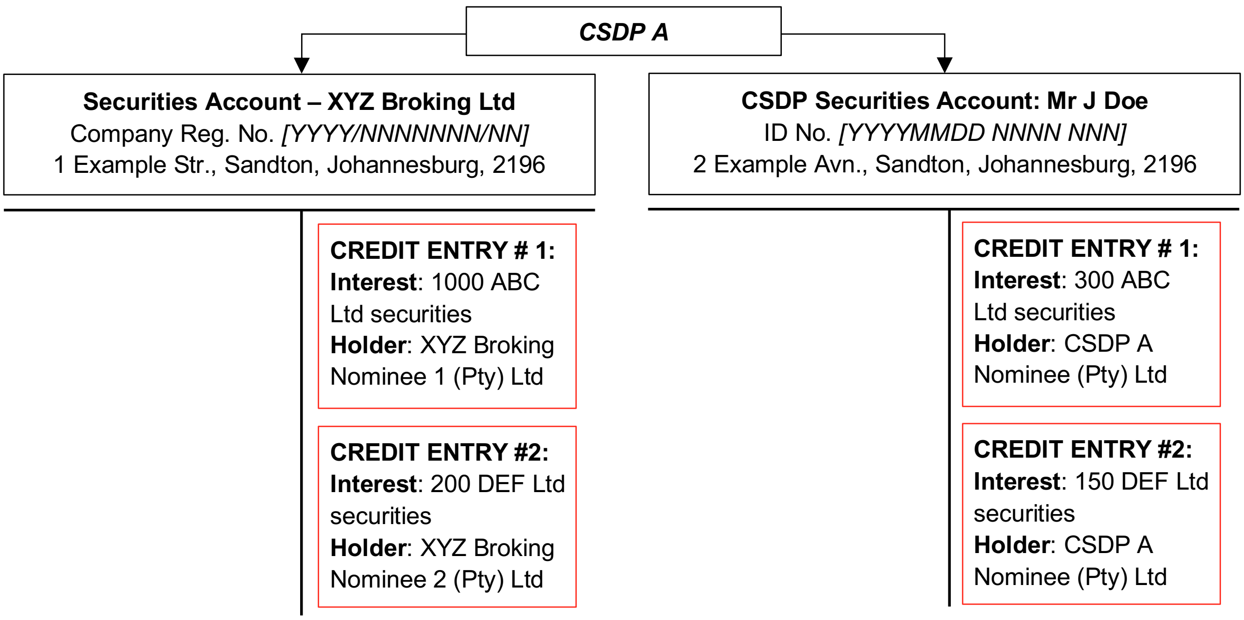

Figure 1: a representation of securities accounts maintained by a CSDP under the SSA and Companies Act of 1973 (with "holder" in the account entries referring to the instrument-holder)

This example is designed to illustrate a number of key properties of the securities account. It illustrates that a client in whose name a securities account was maintained (by the CSDP in terms of the custodial function) was not necessarily the instrument-holder (in terms of the administrative

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44 As per the relevant portion of the definition of "securities account" in s 1 of the SSA.

45 Again as per the relevant portion of the definition of "securities account" in s 1 of the SSA.

46 All the figures found in this chapter are intended as representations, or abstractions, of what the uncertificated securities system's legislative scheme enables, in light of the conclusions of this Chapter on how that scheme should be understood. They are not intended as examples of current practice.

function) for the securities deposited. It also shows that even within a single securities account maintained for a client, different securities could have different instrument-holders. It further illustrates that the *subregisters* for ABC Ltd and DEF Ltd were indeed, as per the quotation above, "a compilation of those records in the various uncertificated securities accounts of the clients of the participants*"* (in this case only one participant is shown). Finally, it shows that the upstream-facing record of instrument-holdership (the entries in the electronic ledger in each account) was functionally and formally different to the downstream-facing record of who the client was (i.e. in whose name the account was being maintained), but that both are necessary for the system to function effectively.

It is submitted that the securities accounts of CSDPs in the *current* iteration function in exactly the same way as the example illustrated above, except in the following four material respects. The first is that Mr J Doe would be able, where the CSD rules allow it, to hold the securities in his own name instead of having to use his CSDP's approved nominee, should he so choose. Second, as there is no statutory mention of a subregister, the entries in the electronic ledger of each CSDP securities account form part of the uncertificated securities register as explained in § 5 1 2 2 above. Third, it may be that the FMA, Companies Act of 2008 and applicable CSD rules in question have different requirements for exact particulars recorded in terms of upstream-facing entries of instrument-holdership and downstream-facing records of the client in whose name the account is being maintained. Fourth, outlined, neatly by the *Explanatory Memorandum to the Financial Markets Bill of 2011*:[47]

> "provision has been made for the UNIDROIT principle of segregation of the funds and securities held by a participant for its own account and those held for or on behalf of clients…[as there was] no provision in the SSA requiring rules to be crafted on the prohibition of debit balances…"

The exact implication of this segregation and the meaning of the duty, in s 32(2)(m) of the FMA, of ensuring that securities "held for or on behalf of its clients are segregated and identifiable as belonging to a specific person" is more fully explored in the next two sections.

5 1 2 4 The nature and function of non-register level securities accounts

There are three kinds of non-register securities accounts: those kept by authorised users, authorised users' nominees, and CSD and CSDPs' nominees. Each will be dealt with in turn.

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47 § 29 at 36 (dealing with amendments in respect of the functions of a participant).

Securities accounts of authorised users?

To analyse these accounts, it is best to begin by establishing a more detailed understanding of the concepts of the "authorised user" and the "client".

The FMA provides definitions for a number of different actors in the chain of intermediation between instrument-holder and asset-holder in the dematerialised depository environment.

The first relevant definition is that of a "client", defined as:

> "any person to whom a regulated person provides securities services, and includes a person that acts as an agent for another person in relation to those services in which case it will include the agent or exclude the other person if the contractual arrangement between the parties indicates this to be the intention…"

The meaning of "securities services" is provided as:

> "(a) the buying or selling of securities for own account or on behalf of another person as a business, a part of a business or incidental to conducting a business;
>
> (b) the use of the trading system or infrastructure of an exchange to buy or sell listed securities;
>
> (c) the furnishing of advice to any person;
>
> (d) the custody and administration of securities by a participant or nominee;
>
> (e) the management of securities and funds by an authorised user;
>
> (f) clearing services; or
>
> (g) settlement services…"

Thus a client is any person, or agent of a person,[48] who is being offered or provided these services by a "regulated person", which in turn is defined as:

> "(a) a licensed central securities depository;
>
> (b) a licensed clearing house;
>
> (c) a licensed exchange;
>
> (d) a licensed trade repository;
>
> (e) an authorised user;
>
> (f) a clearing member;

48 This dispenses with observations in Blackman et al *Commentary* in 5-222 – 5-222-1 that "[i]t is, however, arguable that a nominee, where acting a nominee in the strict sense as interpreted by our courts, would not be a client of the participant…[and should only be seen as a client] where the nominee acts as principal for itself in its relationship with the participant."

(g) a nominee;

(h) a participant;

(i) except for purposes of section 3(6), sections 74 and 75, sections 89 to 92, and sections 100 to 103, an issuer; or

(j) any other person prescribed by the Minister in terms of section 5…"

"Authorised user" is defined by the Act as "a person authorised by a licensed exchange to perform one or more securities services in terms of the exchange rules, and includes an external authorised user, where appropriate."

Finally, "nominee" is defined as "a person approved under s 76 to act as *holder* of securities or of an interest in securities *on behalf of other persons*" [own emphasis].

By virtue of the definition of "securities account" in s 1 of the FMA, it is clear that an authorised user is able (for a client or own name) to: (1) maintain securities accounts, and (2) act as instrument-holder. It is also clear that these two functions (custodial and administrative, respectively) are neither mutually exclusive nor mutually inclusive, but are definitively separate.

Finally, it demonstrates that: (1) a CSDP, authorised user or nominee, (2) a further downstream actor between instrument-holder and end-of-chain asset-holder (e.g. an intermediary who is not an authorised user but a client of one, a bank, or any other service provider to whom these particular "securities services" are provided), or (3) an end-of-chain asset-holder, may be a "client" of its relative upstream intermediary in relation to these functions.

A fairly complex permutation could be illustrated as follows:

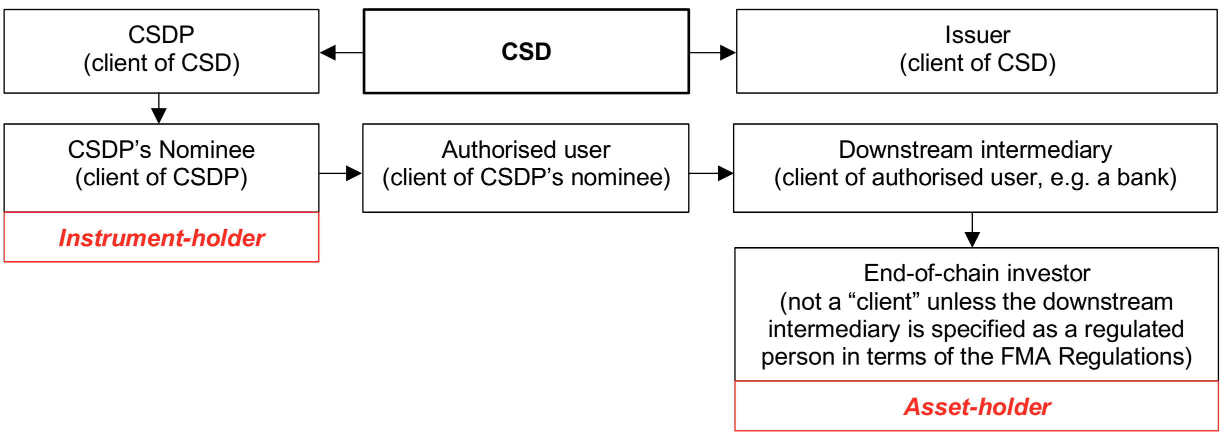

Figure 2: "clients" of "regulated persons"

In accordance with § 5 1 2 2 above, without the amendment of s 53 of the Companies Act, section 1 (*viz.* "uncertificated securities register") of both that Act and the FMA, and other incidental statutory amendments, entry in a securities account of an authorised user could not constitute an entry in the uncertificated securities register. What is, then, the meaning of “held” in relation to keepers of securities accounts that do not constitute the register, and what is the nature and function of such securities accounts?

It is submitted that the only logical way forward is to regard these securities accounts as regulated *records* in the exchange environment (the sections on authorised users are also found in Chapter III of the FMA – “Exchanges”), and therefore pertain only indirectly to the custody and administration of uncertificated securities. This is also supported by the *Explanatory Memorandum to the Financial Markets Bill of 2011*:[49]

> “Authorised users will be required to deposit own securities and those of clients in separate securities accounts and to ensure that they are identifiable as belonging to a specific person. *Due to the equal but different applicability of this provision to both the exchange and CSD environment, a distinction needs to be drawn between segregation requirements for authorised users and those relating to participants*.”

Despite their maintaining “securities accounts” in the technical, FMA-defined sense it must follow, therefore, that no securities can be “deposited” in a similarly technical sense with authorised users, and further that *entry* in such an account will also not have the same effects as entry in an account constituting the uncertificated securities register. Ultimately, it remains true that:[50]

> “Ownership continues to vest in the investor and mutates to a co-ownership interest in the total number or nominal value of securities held in collective custody by a participant or central securities depository. The uncertificated securities *register* continues to found holding…Holding or co-holding is therefore a combination of the entitlement to receive benefits on behalf of the owner and a package of duties owed by the holder to its client.
>
> …
>
> An account credit is not a share or security. *It rather represents all the duties of an agent, or stated inversely, all the rights that a client has against his custodian*. It is also a numerical representation of the proportion of higher-tier holdings. This numerical value, at the same time, gives an indication of the client’s [portion] of dividends or monetary contributions received by the custodian in bulk. At the same time, some rights against third parties are built into this relationship, such as protective measures against a custodian’s creditors. The law [regarding these] accounts is a law of relationships. To conceive of account credits as assets in their own right may be a helpful fiction, but it would lead to the same conceptual fault that was perpetuated by the conflation of the share with the share certificate.”

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49 § 19 at 29 (dealing with the addition of what is now s 22 of the FMA) [own emphasis].

50 Meissner (2019) 244 and 245 [own emphasis].

A particularly strong indication of this position can be found in the wording of s 22 of the FMA ("Segregation of securities"):

> "(1) Every authorised user must deposit securities held for its own account and for or on behalf of its clients in separate securities accounts or other accounts, *maintained by the person who holds or otherwise safeguards such securities on behalf of the authorised user*…;
>
> (2) (a) Every authorised user must balance and reconcile the aggregate number of *each security* reflected in securities accounts *maintained by the authorised user*, and *held by a participant, another third party, or a licensed central securities depository* if so authorised by the registrar, *on behalf of* the authorised user and its clients, with the number of securities *held by the participant, other third party or licensed central securities depository*, whichever may be applicable, on a daily basis unless otherwise provided for in the exchange rules."

The emphasised parts of these provisions indicate that the intention of the legislature (which is not elsewhere obviously evident) is that securities accounts in the technical sense may be maintained by authorised users. However, these accounts merely exist as *records* reflecting : (1) the securities held in the uncertificated securities register, and (2) for whom the account is kept – all "to extend the necessary investor protections to the whole holding chain, i.e. CSDPs, authorised users and nominee holding levels."[51]

In this way, s 22(1) requires a true deposit (in the sense used in the FMA and discussed in § 5 1 1 above) of securities by an authorised user into a securities account of a functionary that is able to maintain accounts that constitute the uncertificated securities register (i.e. a CSD or CSDP). This also then makes greater sense of s 22(2), which imposes a duty to reconcile what is reflected in those (uncertificated securities register-level) accounts with what is reflected in the subsidiary securities accounts of authorised users and their nominees.

In any other reading of s 22 a problematic circularity emerges, where "held" and "hold" conflate the act of maintaining a securities account (the custodial function) with the act of instrument-holdership (the administrative function). As should already be clear, these are fundamentally different functional acts.

However, in form and function s 22 securities accounts are very similar to the securities accounts of CSDPs with the important exceptions that (1) their content does not constitute a part of the uncertificated securities register, and (2) the entries reflect information in the next tier, which is not evident in the entries in the securities account kept by the relevant CSDP. It is also submitted, on the basis of securities accounts' upstream-facing function and their definition in s 1 of the FMA

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51 *Explanatory Memorandum to the Financial Markets Bill of 2011,* § 1 *viz.* "securities account" at 13-14. See also § 5 1 3 below.

(coupled with the definition of “entry”), that their entries *must* reflect the contents of the uncertificated register (and therefore instrument-holdership).

By way of illustrative representation (based on the securities account kept by CSDP A for XYZ Broking Ltd. in *Figure 1* above):

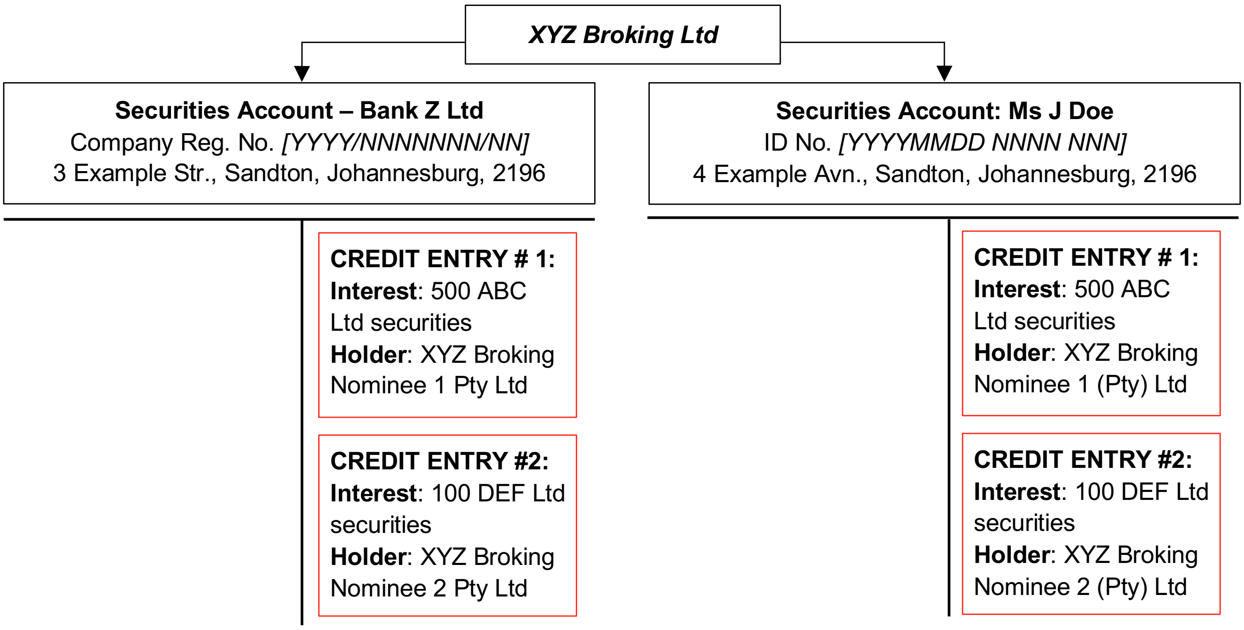

Figure 3: a representation of the securities accounts of an authorised user (with “holder” in the account entries referring to the instrument-holder)

Securities accounts of authorised users’ nominees?

It should follow, by virtue of the nominee’s representative nature, that the same position must apply where securities accounts are maintained by nominees of authorised users, for the same reasons.[52]

Securities accounts of nominees of CSDs and CSDPs?

The position regarding CSD and CSDP nominees’ securities accounts is slightly more difficult to ascertain. On the one hand one may argue that a “nominee” as agent in the scheme of the FMA is empowered to do what its principal is empowered to do. By that reasoning, the maintaining of securities accounts by CSD and CSDP nominees could constitute the maintaining of the uncertificated securities register on their behalf (as has been suggested, in § 5 1 2 3 above, this may have been the case under the previous iteration of the custodial system). On the other, one may

52 See in this regard Yeats et al *Commentary 2008* 2-991, noting in terms of an accompanying diagram [displayed in the portion quoted in § 5 1 2 2 above]: “The nominee securities accounts detailing investor interests kept by approved nominees do not form part of the uncertificated securities register.”

argue that the FMA and Companies Act are definitive in stating that only CSDs and CSDPs are statutorily enabled to maintain the register to the exclusion of all others.

Ultimately, under the FMA, the latter is the most convincing argument on balance, primarily because: (1) the definition of nominees explicitly limits their function to being the "holder of securities or of an interest in securities" on another's behalf; (2) the definition of "securities account" is entirely different from its predecessors; (3) s 53 of the Companies Act and the definition of "uncertificated securities register" in s 1 of both that Act and the FMA makes no mention of nominees, where elsewhere in the FMA they are often explicitly included, where required; and (4) the use of the phrase "custody and administration of securities by a participant or nominee" in the definition of "securities services" is not specific enough to override the considerations already mentioned.[53]

Just as was the case for the SSA, this has the unfortunate consequence of rendering the already vague meaning of "held by…[an]other third party" in s 22(2) very difficult to understand, other than in the context of an outsourcing agreement with an agent (most likely a nominee, or an out-and-out third party vendor in respect of those services).

Legislative change, taking into account the fact that the custodial and administrative meanings of *held* are no longer the same, is strongly recommended to address this issue.

5 1 2 5 Segregation and traceability

This view of (1) the structure of the uncertificated securities register, (2) register and non-register securities accounts, and (3) the functions of the securities account finally brings one to a discussion of segregation and, ultimately, *traceability*. This is of some importance in understanding "ownership" of uncertificated securities, which will be taken up in the next section.

For present purposes, the work of the previous two sections, seen together, provide clarity in one important respect: it is in the nature of all securities accounts to serve a dual informational purpose within the uncertificated system. First, they reflect instrument-holdership by entry ("the number or nominal value of securities of each kind held for…own account or on behalf of…[a] client or person, as the case may be, and all entries made in respect of such securities"), fulfilling an upstream-facing informational function. Second, they reflect for whom they are kept ("an account kept…for its own account or for a client"), fulfilling a downstream-facing informational function.[54] This applies across

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53 Supported, again, by Yeats et al *Commentary 2008* 2-991 in respect of the diagram.

54 Section 1 *viz.* "securities account" of the FMA for what is quoted. "Upstream" meaning facing up towards the CSD; "downstream" meaning facing down towards the end-of-chain investor.

all register-level and non-register level securities accounts as defined in s 1 of the FMA, as is clear from the definition.

Regarding the accounts and records of CSDs, CSPDs, and nominees (presumably because it speaks directly to the custody and administration sphere, it excludes authorised users), s 35(7) establishes that:

> "Any securities held by a central securities depository, participant or nominee for or on behalf of another person must be segregated and identifiable as belonging to a specific person and are considered to be trust property as defined in the Financial Institutions (Protection of Funds) Act, and that Act applies to those securities."

Section 1 of the Financial Institutions (Protection of Funds) Act[55] ("FI Act") defines "trust property" as:

> "any corporeal or incorporeal, movable or immovable asset invested, held, kept in safe custody, controlled, administered or alienated by any person, partnership, company or trust for, or on behalf of, another person, partnership, company or trust, and such other person, partnership, company or trust is hereinafter referred to as the principal"

This very expansive definition and its effect on "ownership" of securities is discussed more fully in the following section. However, for these purposes the following observations in respect of the above definition in the FI Act are sufficient.

The distinction between maintaining a securities account (the custodial function) and acting as instrument-holder of an uncertificated security (the administrative function) is of great importance in determining the meaning of "ownership" in the FI Act. This distinction, read with the outcomes of Chapter 4 as well as s 36(2) of the FMA, indicates strongly that the instrument-holders, asset-holders, and other possible holders of limited real interests in securities are the only persons who can have direct (lawful) holdership of any element of the underlying interest of a security. This alone leads to two useful conclusions.

First, for the custodial function, it follows that custodial functionaries (i.e. CSDs, CSDPs, and perhaps also authorised users and nominees) acting in that capacity (maintaining securities accounts as distinguished from acting as instrument-holder) can have no proprietary interest in those securities by virtue of their custodial roles. This is in line with s 36(2) of the FMA and is also supported by the courts' approach to the FI Act as demonstrated by *Louw NO and Others v Coetzee and Others*,[56] as

[55] 28 of 2001.

[56] [2003] 1 All SA 34 (SCA), and specifically paras. [5], [6], [8], [10], and [14]-[15].

well as *Executive Officer of the Financial Services Board v Ovation Global Investment Services (Pty) Ltd & Another*.[57]

Thus it seems incorrect to argue that, by virtue of s 35(7) read with the definition of trust property in the Financial Institutions Act, "the FMA introduces a form of dual ownership with the uncertificated securities subject to a statutory trust with the central securities depository having legal ownership and the investor being vested with beneficial ownership in a manner comparable to that recognised in English law."[58]

Instead, with the right understanding of the wide meaning of deposit within the scheme of the Act, it is most sensible to argue that the definition in the FI Act applies to institutions in the specific capacity in which they act. For the custodial function, the definition covers "incorporeal, moveable…asset[s]…kept in safe custody…[and/or] administered" by these institutions. The relationship of trust implied (and all consequent statutory protective controls) by the FMA's confirmation of the application of the FI Act must therefore be understood as one of informal trust, rather than any proprietary trust in the formal sense (*bewind* or otherwise).[59] Nothing in the FI Act suggests that it applies to formal trusts only; in fact, s 2 explicitly recognises fiduciary agency in using the phrase "instrument or agreement by which the trust or agency in question has been created." It is submitted that the use of "agency" here, when read with the definition of "trust property", should be read to include species of *mandatum* as well. The only exception would be those rare bearer securities physically deposited with such a custodial institution – here the securities would naturally become the property of the institution in the full sense.

Second, for the administrative function, it indicates that CSDPs, their nominees, and authorised users' nominees (as well as, in all likelihood and despite their explicit exclusion, authorised users) who are *acting as instrument-holders* are included for a different reason. Here the definition in the Financial Institutions Act most likely applies to these institutions in this specific capacity because it includes "incorporeal, moveable…asset[s]…held…or controlled" by these institutions as instrument-holders.

This, on the other hand, is indeed a proprietary (though, as per Chapter 4, non-patrimonial) relationship to the underlying interest of the security: holdership of the incidents of execution. Yet,

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57 *(Ovation Preservation Pension Fund, Ovation Preservation Provident Fund, Ovation Preservation Annuity Fund & Metropolitan Life Ltd Intervening)* [2007] 4 All SA 741 (C) paras. [5]-[17].

58 Yeats et al *Commentary 2008* 2-599 & 2-623 – 2-630. The authors appear also not to favour this interpretation – see 2-630.

59 See for instance the discussion of the possible import of the FI Act in respect of "co-ownership" of uncertificated securities in Yeats et al *Commentary 2008* 2-606 – 2-610, though as discussed in § 5 1 3 below this view is not supported here.

again, it need not rise to the level of a "statutory" trust – merely a fiduciary relationship of trust, which is already inherent in instrument-holdership. The exposition regarding the content and dynamics of the unique relationship of fiduciary agency between instrument- and asset-holder outlined in § 4 3 1 of Chapter 4 is strongly supportive of this conclusion.

With this in mind, beginning with CSDs, what are the relevant duties in maintaining central securities accounts? Section 30(2) of the FMA states that CSDs:

> "(a) must constitute, maintain and provide an infrastructure for holding uncertificated securities which enables the making of entries in respect of uncertificated securities;
>
> (b) must perform custody and administration in respect of a central securities account;
>
> …
>
> (k) must maintain a central securities account with due regard to the interests of the participant and its clients;
>
> (l) may hold all securities of the same kind deposited with it by a participant collectively in a separate central securities account…"

Thus, a CSD must maintain at least *a* central securities account for each participant, reflecting all deposited securities including, as per the meaning of deposit, dematerialised securities and securities issued in uncertificated form, as well as possibly immobilised certificated or bearer securities. It may also keep separate central securities accounts for each security "of the same kind" (i.e. of the same class and issue) deposited by a CSDP. Own name accounts for asset-holders or approved nominees are also enabled, along with accounts for external CSDs.[60]

Section 37(5) determines that securities under the custody of a CSD must "be segregated and identifiable as belonging to a specific person". According to the *Explanatory Memorandum to the Financial Markets Bill of 2011*:[61]

> "a provision has been made for the UNIDROIT principle of segregation of the securities held by a participant for its own account and those held for or on behalf of other persons. Currently, there is no provision in the SSA requiring rules to be made on the prohibition of debit balances. This has now been provided for in the Bill. It is clear in practice (internationally and nationally) that the CSD Rules and Directives could make provision for intraday debit balances in certain circumstances, as long as it does not flow into the next business day."

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60 As per s 1 (*viz.* "central securities account") of the FMA – the provision for any other persons specified in the depository's rules is the central enabling provision for own name account-holding.

61 § 32 at 38 (dealing with the amendments with the requirements with which the depository rules must comply).

Though this quotation does not pertain directly to s 37 or CSDs themselves, similar commentary is found pertaining to each proposed section of the Act in which the duty of segregation is imposed with this specific language (see below, as each is dealt with in turn). Yet the precise meaning of this phrase, "segregated and belonging to a specific person" is difficult to understand.

The reference to the UNIDROIT principle is to articles 24 and 25 of the *UNIDROIT Convention on Substantive Rules for Intermediated Securities*.[62] Read against the Convention, it is clear that the provision has two sets of objectives. The first is to stabilise the custodial system and mitigate systemic risk, through the prevention of non-intraday debit balances[63] and the related issue of shortfalls between what is credited and what is actually held, as well as the insulation of client (and ultimately investor) holdings in case of insolvency of intermediaries. Second, it aims to improve traceability of holdership within the system and, when read with the expansion in s 1 *viz.* "securities account" and the provisions of s 22, in so doing "to extend the necessary investor protections to the whole holding chain…"[64] Here security of transfer, as determined by s 41 of the FMA and s 53(4) of the Companies Act, is of great importance, but is primarily dealt with in Chapter 10 of this work.

What is clear from the previous two sections is that each central securities account will include *entries*, reflecting instrument-holdership (and will form part of the uncertificated securities register). Thus interpreting the phrase, and specifically the use of "belonging", to mean that each *instrument*-holder must be separately identified would not only be superfluous but also nonsensical.

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62 of 25 September 2013. Article 25 includes that:

> "1. Securities and intermediated securities of each description held by an intermediary as described in Article 24(2) shall be allocated to the rights of the account holders of that intermediary, other than itself, to the extent necessary to ensure compliance with Article 24(1)(a).
>
> …
>
> 3. The allocation required by paragraph 1 shall be effected by the non-Convention law and, to the extent required or permitted by the non-Convention law, by arrangements made by the relevant intermediary.
>
> 4. The arrangements referred to in paragraph 3 may include arrangements under which an intermediary holds securities and intermediated securities in segregated form for the benefit of:
>
> (a) its account holders generally; or
>
> (b) particular account holders or groups of account holders,
>
> in such manner as to ensure that such securities and intermediated securities are allocated in accordance with paragraph 1.

Article 24, as referred to, requires:

> "An intermediary must, for each description of securities, hold or have available securities and intermediated securities of an aggregate number or amount equal to the aggregate number or amount of securities of that description credited to:
>
> (a) securities accounts that it maintains for its account holders other than itself; and
>
> (b) if applicable, securities accounts that it maintains for itself."

63 Debit balances are only possible where the securities of the custodian, and of the custodian's clients, are not individuated.

64 National Treasury *Explanatory Memorandum to the Financial Markets Bill of 2011*, § 1 at 13-14 (dealing with the amendments to the definition of securities account).

Interpreting the phrase to mean that each asset-holder must be indicated is also clearly incorrect. The South African system remains primarily, but not entirely, *non-transparent*,[65] and it is further clear that in more complex patterns of holdership, the end-of-chain investor may not be a "client" as per the FMA and would therefore not be identified within the chain of securities accounts (see for example *Figure 2* above). In these cases one or more unregulated,[66] *further* intermediary is interposed between the investor (asset-holder) and the lowest tier custodial functionary, so asset-holdership may not be fully traceable *within* the regulated system of upstream-facing entries or downstream-facing client records. In such cases, what is required to be recorded within the system will end with the identity of the unregulated intermediary. In this way, the possibility of reading "belonging to a specific person" as referring to *asset-holdership* is also fairly convincingly excluded.

The most convincing interpretation is that the phrase is intended to mean that the custodial functionary must ensure that all its securities are *identifiable as being held* (in the custodial sense) *for a specific client* (in this case the CSD holding for a CSDP as client). The key secondary interpretive problem that then arises is as follows:[67]

> "What is unclear from the provisions of the Act and Rules is whether securities must be segregated in such a way that specific securities can be allocated to specific clients or whether it is sufficient if a custodian separates own securities from a pool of collectively held client securities. The wording of the provisions points towards the former interpretation, but this would effectively bar any pooling or collective holdings of securities. Considering the purpose of the duty, which is to prevent the mixing of client property with an agent's property, it can be argued that the latter interpretation can find application as long as client accounts record the holding of each client in relation to the pool."

This work also strongly favours the first interpretation, which is well illustrated by the downstream-facing details in the securities accounts of *Figures 1* and *3* above (which also show that the policy outcome of traceability is not precluded by this interpretation). It will be shown in the next section that it may not be altogether correct to assert, as above, this this effectively precludes pooling. However, the second interpretation remains possible, in which case further details in each account entry would be required to achieve such segregation effectively. This point is not as important in the context of CSDs as it is in the context of the securities accounts of CSDPs, authorised users and nominees, and will be illustrated below in the example in *Figure 4*.

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65 See Vermaas (2010) *Acta Juridica* 99 & n 66, as well as 95-97, and Meissner (2019) 223 & n 22.

66 In this context, "unregulated" means unregulated *by the FMA* and but not necessarily unregulated by other financial legislation such as the Financial Sector Regulation Act 19 of 2017, the Financial Advisory and Intermediaries Services Act 37 of 2002, or the Banks Act 23 of 1965.

67 Meissner (2019) 238.

Turning thus to CSDPs, the FMA expands upon s 37(5), including as one of the many duties of CSDPs, in s 32(2)(m), that such a participant:

> "must deposit securities held by it for its own account and those held for or on behalf of its clients in separate securities accounts and must ensure that securities held for or on behalf of its clients are segregated and identifiable as belonging to a specific person..."

Following the same logic (but drawing now from the definition of "securities accounts"), one uses the same reading of "belonging to a specific person" to conclude that a CSPD must reflect for whom it is maintaining each securities account, as demonstrated in *Figure 1*. However, on the possibility of interpreting the provision to allow single securities accounts for more than one client, an illustrative representation could be as follows:

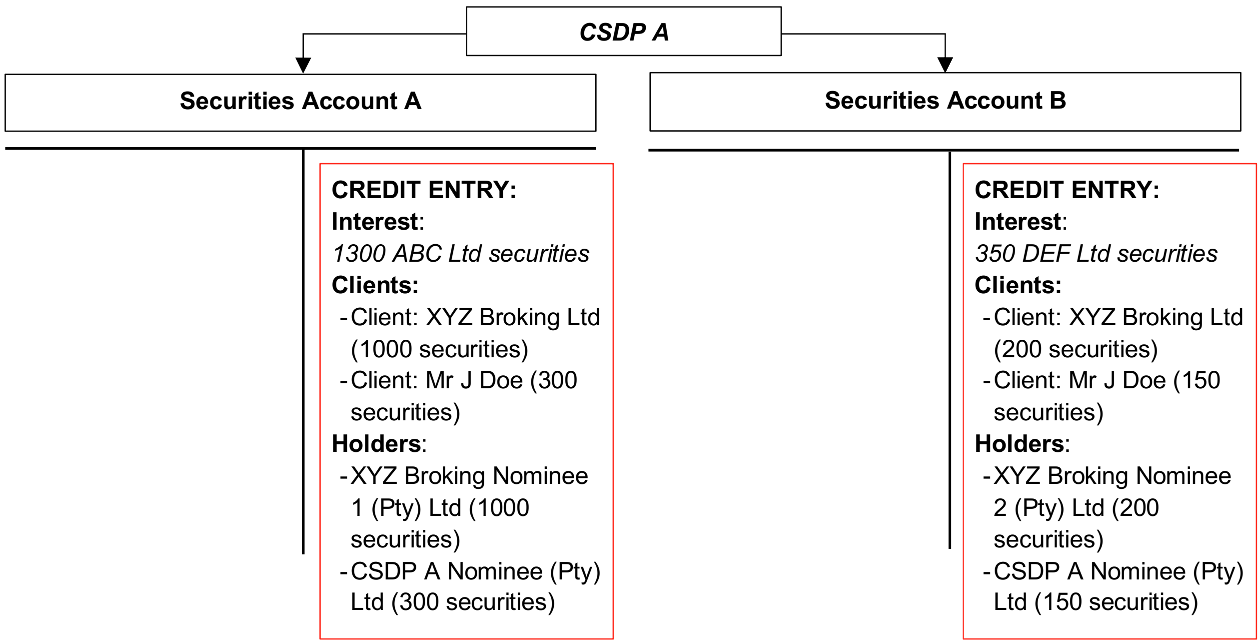

Figure 4: a representation of securities accounts maintained by a CSDP (with "holder" in the account entries referring to the instrument-holder)

This example shows the accounts and their entries carry the same information as in *Figure 1*, but in a somewhat more convoluted manner. One key concern is that increased complexity of entry means increased complexity in what is required for netting and transfer. This would be especially so if a transfer were to occur, for instance, between XYZ Brokers Ltd and Mr J Doe – how would the debiting and crediting requirement of s 53 of the Companies Act (which is required for the transfer of asset-holdership) be satisfied? This is dealt with in detail in § 8 2 of Chapter 8.

From the nature of the security instrument, it is trite that the uncertificated securities register as constituted from the accounts of the CSD and any CSDP will only reflect instrument-holdership. Nonetheless total *security*-holdership also remains entirely possible. It is possible with respect to securities held by a CSD or CSDP for its own account (i.e. where it is also asset-holder), as well as where their downstream *clients* reflected as instrument-holders are also the asset-holders (though this is, under the current primarily non-transparent system at the JSE, a minority of cases where an *own-name* SDA account is held).[68] In these cases the register will actually reflect *security*-holdership.

Finally, what about the subsidiary ('non-register') securities accounts maintained by authorised users and nominees?

For authorised users, in this context, s 22 requires that:

> "(1) Every authorised user must…ensure that securities held for or on behalf of its clients are identifiable as belonging to specific persons.
>
> …
>
> (3) Any securities held by an authorised user for or on behalf of another person must be identifiable as belonging to a specific person and are considered to be trust property as defined in the Financial Institutions (Protection of Funds) Act, and that Act applies to those securities."

The key issue here is whether it makes sense to interpret "belonging to a specific person" differently for non-register securities accounts than for CSDs and CSDPs.

Is the intention that these accounts reflect instrument-holdership (as a reflection of the consolidated uncertificated securities register as maintained by a CSD and CSDPs) and to whom the securities "belong" (which as explained above is a misnomer for the person *for whom* the account is maintained), or should these accounts reflect the actual end-of-chain patrimonial interests of the asset-holders?

The latter interpretation, which enjoys some support,[69] could mean that the system operates, holistically, to ensure that a periodically reconciled record must be kept of: (1) the uncertificated instrument-holder as per the accounts of the CSD and CSDP in terms of s 32(2)(m); *and* (2) the

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68 Even, for example, under Strate Ltd.'s "SDA" system, *only* SDA clients holding securities *directly in own name* would have full security-holdership, and SDAs for approved nominees would only reflect instrument-holdership.

69 Most notably the authors in Yeats et al *Commentary 2008*, discussing the "co-ownership interpretation" of the custodial system (which is cited as the work's preferred interpretation) at 2-608 – 2-611, and specifically at 2-609:

> "The fact that there is generally a hierarchical series of securities accounts between an investor and the securities held in a central securities depository makes it challenging to determine which securities account is relevant for the purpose of determining the investor's co-ownership interest. It is submitted that it would not make business sense to read the provision as regarding investors as having different co-ownership interests depending on which level in the custodial 'hierarchy' one looked at. To avoid this, it is submitted that it makes sense to read the provision as taking into account the 'hierarchy' and work from the 'top-down' to the securities account reflecting the investor's interest. That is, *if the investor's specific interest is only recorded in an approved nominees securities account*, one would look to the credited holding of the relevant participant in the central securities account…" [own emphasis]

Nonetheless, it is shortly thereafter conceded that a "key issue in this regard is that the securities accounts are only evidence of the holding in the relevant account and therefore may not reflect the actual position and, traditionally, ownership vests independently of the registered holdings."

uncertificated *asset-holder* as per the non-register accounts of authorised users in terms of s 22. If so, each security is traceable as belonging to a specific instrument- and asset-holder, respectively, *within the system of securities accounts.* This interpretation is important not because it is correct but because it is strongly indicative of the policy outcome desired – that the ambit of the regulated system, *as far as possible*, has within it the details of the asset-holder.

Unfortunately, as illustrated in *Figure 2* above, it is quite possible that the client of an authorised user is not the end-of-chain asset-holder. In that case the system will not necessarily reflect the end-to-end holding chain between instrument-holder and ultimate investor (as demonstrated by *Figures 3* and *4*) – merely instrument-holdership and the next downstream intermediary "client" (who does not necessarily have any proprietary patrimonial interest in the held securities).

A second factor militating against this reading is that nominees are included in s 37(5), but without due differentiation between the nominees of CSDs and CSDPs, and those of authorised users, respectively. Two divergent interpretations of the same provision for register-level securities accounts and non-register securities accounts seems unlikely.

Third, bearing in mind the analysis above regarding the difficulties encountered in the Act's inherited use of "held", it is not particularly contentious to assert that held should be interpreted within the definition of "securities accounts" as referring to the administrative function (instrument-holdership), and therefore that it should also be similarly interpreted in s 22(12) and (3).

Fourth, there is another key provision in the FMA that regulates the duties of authorised users' securities records – s 19:

> "**Marking of or recording details of securities** — When a document of title relating to listed securities comes into the possession of an authorised user, the authorised user must, as soon as possible –
>
> (a) mark it; or
> (b) record and store the necessary details, in a manner which will render it possible at any time thereafter readily to establish the identity of the owner of those securities."

The next section will argue that the correct meaning of "ownership" as found in the statutory framework is in reference to *asset*-holdership. Assuming this to be the case the use of the term "owner" in this provision, in contradistinction to the phrase "belonging to" employed by s 22, makes the prospect of a securities account intended to reflect asset-holdership directly even more unlikely. The "or" in s 19 further demonstrates that this outcome has been considered by the legislature.

However, the *Explanatory Memorandum to the Financial Markets Bill of 2011*, envisioning extension of the "necessary investor protections to the whole holding chain", is evidence that the act wishes asset-holdership to be reflected within the system of accounts in so far as it is possible. In other words, it is beneficial to extend these duties downstream as far as the last "client", so that all clients who are indeed also asset-holders enjoy enhanced protection.

The critical investor protections referred to appear to be: (1) finality of transfer; (2) protection from the insolvency of a CSD or CSDP; and (3) risk-sharing in case of a shortfall in the number of securities under the custody and administration of a CSD or CSDP, or downstream intermediary. There are compelling reasons why one could argue that the act is successful in extending these protections although fact patterns may emerge where this seemingly "final" client is yet another intermediary for an end-of-chain client (again, as illustrated by *Figure 2*).

The latter two protections are successfully ensured by reading the provisions as regulating the custodial and administrative functions alone, without the need for direct records of asset-holdership. Due to the delineating and "bundling" function of the security instrument (also discussed in the following section),[70] the securities register alone will adequately determine the extent of any shortfall because the register-level securities accounts serve as record of the number of securities (1) held administratively by instrument-holders, and (2) held custodially through the act of maintaining securities accounts.

Thus, any shortfall will be accurately and correctly apportioned and the risk and shortfall shared accordingly. Section 36(2) and the interpretation of s 37 offered in the next section (supporting the "co-ownership", or preferably co-asset-holdership, construct), together with the import of the FI Act, further ensures that the insolvency of a CSD or CSDP should not affect the patrimonial position of asset-holders, as the former two hold no patrimonial interest in any security of which they are not also asset-holder.

In terms of the first (finality of transfer), regulation of instrument-holdership alone is also sufficient. When transfer of instrument-holdership by register entry is understood as a formality requirement (*quasi-traditio*) for the transfer of the security asset (as is argued is the case in § 8 2 2 of Chapter 8), the protections of finality of transfer hinge on such a register entry, and again the records pertaining

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70 This function is alluded to in Chapter 4, in § 4 1 3:

> "as a locus for the execution of the collective sum of rights and competencies, [the security instrument] facilitates the conglomeration, or bundling, of rights in cases where a security is comprised of more than one personal right. All rights and competencies accruing to a security must, by necessity, be administered through the instrument(-holder), so that these components of the underlying interest are bound together by it."

The point is further elaborated upon in Chapter 6, § 6 3 3 2, this is also discussed, under the *indicium* "*Bundling*", as follows:

> "The [security] instrument increases the economic efficiency of a complex and multi-party borrowing arrangement by creating a single person *to perform towards* (the instrument-holder), irrespective of the identity of the person entitled to the beneficial results of such performance. A corollary of this is that, no matter what the underlying interest consists of, benefits will always *flow through that instrument* – in other words, the instrument has a strongly *cohesive* effect on the various elements of the underlying interest.

to any non-securities account administering clients or end-of-chain asset-holders are not essential for its protective effect. This is further dealt with in § 9 2 of Chapter 9.

Consider the following potential chains of holdership:

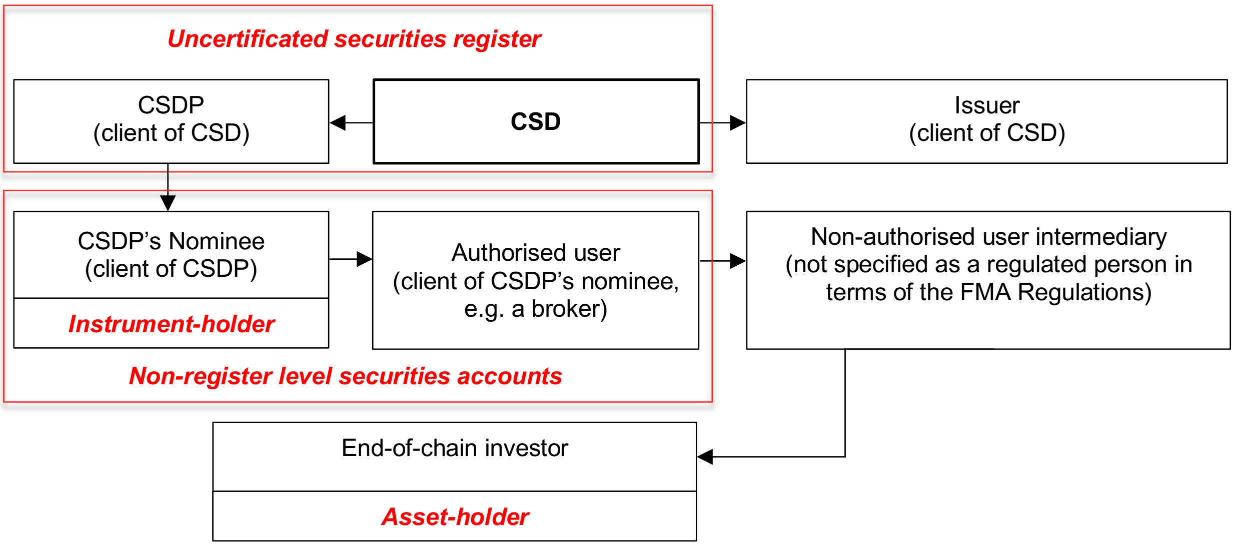

Figure 5: complex intermediated holdership

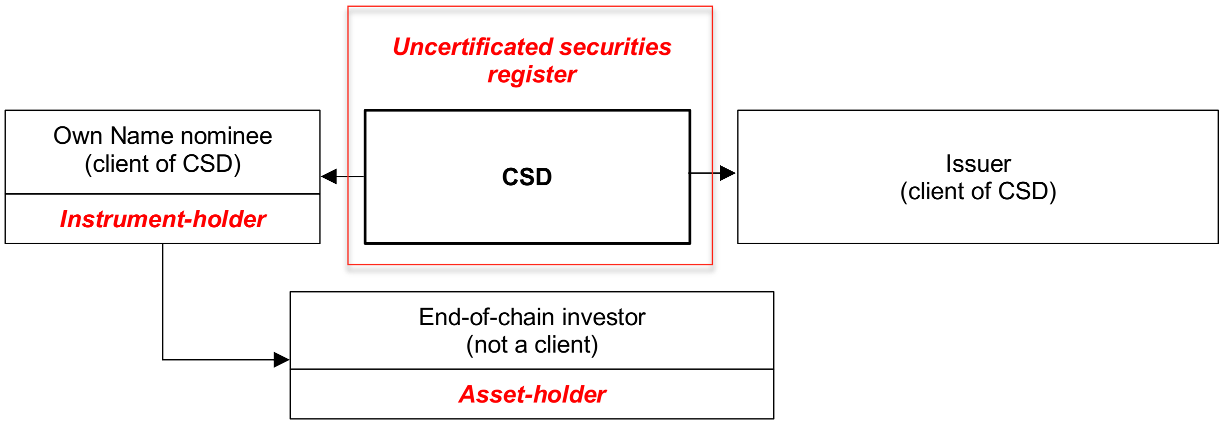

Figure 6: simple intermediated holdership

In these instances, taking the interpretive stance presented, it would appear as though the records of asset-holdership are not regulated by the FMA or related delegated legislation.[71] However, when paired with a sound understanding of the co-ownership construction (as discussed in the following section) and the key role of (register-level) securities account entry as a hard formality requirement in *quasi*-delivery for the transfer of the security asset, the system appears quite sound.

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71 Even the Strate Rules appear not to deviate from the wording and definitions used in the FMA in any meaningful way in this particular regard – see Strate Ltd *Rules of Strate Ltd* [Reg. No. 1998/022242/07] (updated as per Government Gazette No. 41132 22 September 2017).

Ultimately, the traceability of asset-holdership, and identity of the true asset-holder, remains fundamentally an evidentiary matter. In this sense the size and scope of the economic activity of securities holdership and trading does not make this position particularly anomalous – the funds held in bank accounts and their electronic transfer are similarly evidentiary matters in the context of a legal dispute, and are highly comparable in terms of value and velocity. To borrow a phrase from s 22A of the Financial Intelligence Centre Act,[72] all that is necessary in terms of a past securities transaction are the records "that are reasonably necessary to enable that transaction to be readily reconstructed". Section 56 of the Companies Act is a further tool, if correctly utilised and complied with, to ensure the end-of-chain asset-holder is identifiable, and that transparency exists in a manner that does not affect, dilute or impugn on the established rights and duties of the asset- and instrument-holder of any particular uncertificated security within the system.

There is also the obvious economic (mainly financial and reputational) incentives of downstream intermediaries who do not maintain any kind of securities accounts to keep sound records of asset-holdership and holdership of other limited real interests in securities. Further, each securities transaction will be accompanied by records of an electronic funds transfer from the prospective asset-holder (or acquirer of a limited real interest in securities), after which there will be evidence of a flow of funds through the applicable intermediaries into the clearing and settlement system (whose records are regulated in terms of both Chapter V of the FMA and in terms of the national payments system). The transaction will ultimately result in a register entry of the sort required for the transfer, as well as payment to the disposing asset- or real interest-holder in a similar fashion. Finally, it is rather improbable that any securities transaction would occur without a documentary record of the necessary supporting contractual and pre-contractual undertakings between investor and her direct mandated intermediary, and similarly between that intermediary and others until the transaction enters the clearing and settlement environment.

In short, from a policy perspective, with any shortfalls apportionable through records of instrument-holdership in the non-register and register-level securities accounts, the insolvency of any custodial functionary aptly regulated, and the necessary ancillary remedies in place (such as in s 44 of the FMA), the view presented does not seem to leave the position of any individual investor, or the stability of the system at large, in any true jeopardy.

[72] 38 of 2001.

5 1 3 “Ownership” of uncertificated securities

The keystone for the proposed scheme of interpretation of the FMA is understanding “ownership” of uncertificated securities in light of the co-ownership construct ostensibly imposed by s 37 (and to a more limited degree its interplay with s 36).

Under the older immobilisation and uncertificated securities regimes, any holders of securities of the same class and issue which were deposited without full segregation in a “repository” obtained as consequence a proportional “co-ownership” of the entirety of the deposited “fungible bulk”.[73] However, without the outcomes of Chapter 4, specifically its harmonisation of the “dual ownership” feature of English registered securities with the doctrinal characteristics of South African private law, there does not appear to be perfect clarity about the meaning of ownership, and therefore co-ownership, in the South African legal landscape. As will be shown, this problem is particularly acute when attempting to understand why so-called “omnibus” holding of security instruments by intermediaries causes the underlying patrimonial substance of securities to commingle despite their being held by individual end-of-chain investors.

This section will suggest that in the custody and administration of uncertificated securities: (1) “ownership” refers to end-of-chain *asset*-holdership rather than instrument-holdership; and (2) on that basis that “co-ownership” so understood becomes a key enabling building block underpinning the South African uncertificated regime, supporting the above interpretations regarding deposit, entry and the account-based structure of the custody and administration system, and facilitating a sound understanding of the legal consequences with respect to the pooling of securities of the same class and issue within a securities account.

5 1 3 1 The meaning of ownership

The first step, then, is to develop a proper understanding of the meaning of “ownership” when used in the FMA (and the Companies Act) in the custody, administration, and transfer of uncertificated securities.

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[73] See Malan *Collective Securities Depositories* 230-236 as extensively quoted in § 5 1 1 above; Blackman et al *Commentary* 5-205 – 5-206; and also Vermaas (1998) *SA Merc LJ* 174-176.

In the context of securities, the historic meaning of "ownership" leans towards an indication of asset-holdership (i.e. holdership of the beneficial interest). This is in contrast to "title", which in most cases refers to instrument-holdership (i.e. registered holdership), so that:[74]

> "ownership of shares in South African law is completely distinct from, although frequently co-extensive with, the registered title to shares."

Support for this is also found in Blackman et al.[75] Yet dematerialisation has a marked impact on the ownership, or rather holdership, of the security asset. In the context of the older uncertificated securities regime found in the 1973 Companies Act and the Securities Services Act,[76] these authors remark that:[77]

> "[i]n the case of uncertificated securities it would seem that, because the transfer is effected by debiting and crediting, respectively, of both the account in the subregister from which the transfer is effected and the account in the subregister to which the transfer is to be made, it is upon entry of the transferee *or his nominee's* name in a subregister that the transferee becomes owner of the shares (that is to say, he becomes owner of them at the same time as he, *or his nominee*, becomes a member of the company concerned…)."

As a result of a securities-wide convergence on share-based principles in the domestic legal development (due to the large degree of broader share-centricity of South African securities law),[78] debt securities have the exact same structural features. If membership above is taken, approximately, to mean instrument-holdership, then the above is equally applicable to these securities.

A further reason to ascribe a meaning of asset-holdership to the term ownership is the wording of s 38(1)(b) of the FMA. The statement that a transferee is "entitled to all the rights of a transferee of movable property" seems to go beyond the common law affirmation of the "movable" status of securities as property (as found in s 35(1) of the Companies Act).[79] The section seems also to imply

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74 See A Borrowdale "The transfer of proprietary rights in shares: A South African distillation out of English roots" (1985) 18(1) *Comparative and International Law Journal of Southern Africa* 36 36 & 40, including a discussion of *McGregor's Trustees v Silberbauer* 8 (1891) 9 SC..

Further authority is cited therein in n 10: *Farrar's Estate v CIR* 1926 TPD 501, *Jeffery v Pollak and Freemantle* 1938 AD 1 18, *West v De Villie*rs 1938 CPD 96 102, *Moosa v Lalloo* 1956 (2) SA 237 (D), *Davis v Buffelsfontein Gold Mining Co Ltd* 1967 (4) SA 631 (W) 633F, and *Verrin Trust and Finance Corp (Pty) Ltd v Zeeland House (Pty) Ltd* 1973 (4) SA 1 (C).

75 Blackman et al *Commentary* 5-169 – 5-170.

76 36 of 2004.

77 Blackman et al *Commentary* 5-173 [own emphasis].

78 See Chapter 3, specifically § 3 1 3 & § 3 2.

79 See Chapter 2, § 2 2 1, and Chapter 4, § 4 1.

that a transferee is entitled to the *patrimonial substance* of the security. This interpretive view is even further strengthened by two other elements of the scheme of Part IV of the FMA, as well as a third based on the Companies Act of 2008.

The first element is the provisions of s 36(2)(a)(ii)(bb)(cc), s 37(2), s 38(1)(a)-(b), and especially s 40, which make provision for different types of "other rights " or "limited rights" *in* securities. This appears at least to envision limited real rights (i.e. holdership of one or more individual incident-functionalities of the security asset) held by third parties.[80] The import of these sections, seen together and with the definition of "entry" in s 1, seems to make express provision for the entry of other lawful interest-holders, *additional to the primary instrument-* or *security-holder*, on the electronic register (i.e. the relevant CDS and CSDP securities accounts), most notably pledgees. Thus the Act clearly contemplates the obtaining of a limited patrimonial interest through register entry. In the context of the function (and consequences) of register entry, the juxtaposition of "limited interests in securities" and "ownership" is revealing. It strongly suggests that the latter refers to the totality (or, as the case may be, the remaining residual interest) of the patrimonial interest of a security. This corresponds neatly to the essence of asset-holdership.

The second element is the provisions of s 41 of the FMA and s 53(4) of the Companies Act. These provisions provide for security of transfer (also referred to as "the principle of finality" as more fully discussed in § 9 2 of Chapter 9).[81] These sections seek to protect certain good faith, but ultimately defective or unlawful, acquirers of a security and thereby to improve the efficiency and integrity of securities markets' infrastructure (i.e. trading platforms and by implication the broader financial marketplace). This is achieved through entrenching the finality of cleared and settled transactions subject to very few exceptions. In its objective:[82]

> "[t]he rule forms the cornerstone of the integrity of the market and makes the electronic register sacrosanct. This is reflected in the wording that the change of ownership is effective notwithstanding illegality, fraud or insolvency, provided that the transferee acts without notice.
>
> The detail of good faith transferee rules is significantly different in different systems, but the principle is the same worldwide. Securities are intangible assets and may pass through several accounts. *Somewhere in the holding chain there will be a true owne*r, and if there was an illegal double transfer or the title of

80 Chapter 4, § 4 3 2 2.

81 Vermaas (2010) *Acta Juridica* § IV. However, see also J Benjamin *Interests in Securities: A Proprietary Law Analysis of the International Securities Markets* (2000); and Yeats et al *Commentary 2008* 2-595 on the "greater sacrosanctity of the uncertificated securities register".

82 Vermaas (2010) *Acta Juridica* 113 [own emphasis].

> ownership was defective, the good faith transferee will get legal protection in most indirect holding and transfer systems in accordance with this rule."

From a functional-policy perspective, finality of transfer simultaneously protects two discrete elements of the system. On the one hand, it protects the *mechanics* of the market infrastructure by ensuring that transfers of *instrument*-holdership are irrevocable. This enables the critical capacity for volume and velocity needed by the trading infrastructure itself, ensuring transactions need not be halted, investigated, and possibly reversed (especially if the security in question has changed hands several times after the originally defective transfer). On the other, it protects the *value-chain* of the market infrastructure by ensuring that transfer of *asset*-holdership is also irreversible – thus a good faith, and for value, acquirer can be assured, assuming the evidentiary basis for such an acquisition is strong, that the acquisition is firm. These two functions are critical to the integrity of the market.

How, more specifically, is this achieved? The FMA protects transfer of *instrument*-holdership by making "entry…valid and effective" despite a host of potential legal defects. The Companies Act, however, goes further, making the acquisition of "ownership" (expressly in the Companies Act and impliedly by incorporation by reference in the FMA) through debiting and crediting *irreversible*. Does the wording of the Companies Act go further, and cause finality of transfer of *asset*-holdership also?

The principle of security, or finality, of transfer can also be described as follows:[83]

> "[a] transfer is secure if the transferee, being a good faith purchaser, is able to retain the transferred *asset* free from adverse claims."

It would be difficult to assert that this policy position is solely aimed at protecting the position of *nominees* within the system, rather than also the *value chain* of securities transfer itself. *Commentary 2008* also notes, in this regard, as follows:[84]

> "The greatest benefit in relation to uncertificated securities administered by Strate is the reduction of settlement risk derived from the simultaneous payment against transfer of the uncertificated securities. In addition, the removal of certificates and transfer forms from the process clearly reduces the risks associated with certificate theft and fraud. It remains to be seen if there are any risks of information systems and securities accounts being 'hacked' or tampered with.
>
> There are, however, two important drawbacks for the beneficial owner. Firstly, s 53(2) purports to require not only the transfer of registered title to be effected in this manner, but also the transfer of ownership in any uncertificated securities, which raises doubts as to whether it is still possible for the beneficial owner

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83 Benjamin *Interests in Securities* – see generally 73-78, though the topic is primarily dealt with in Chapter 9 of this work.

84 Yeats et al *Commentary 2008* 2-594 – 2-595.

> of the securities to cede beneficial ownership of the uncertificated securities by way of a cession of rights independently of such a registered transfer…Secondly…s 53(4) protects the good faith transferee, which means that the registered holder can be deprived of registered title (and probably also his ownership) without his authorisation and this could effectively deprive the investor of his ownership interest."

Despite these reservations the provisions ensure, by affording the transferee finality of transfer, that good faith acquirers obtain the *benefits* of securities transferred to them, and that trading systems do not have to reverse the flow of value. It is submitted, in this light, that in order for these rules to function properly, "ownership" *must* refer to asset-holdership; conversely, if it did not always mean asset-holdership, a good faith acquirer of value would have to fall back on the difficult remedy of estoppel (as between her and other relevant intermediaries), a state of affairs these provisions seemingly aim to prevent.[85]

The third and final element of the statutory framework which supports this view is the overall scheme of the Companies Act itself, which appears to affirm that "ownership" in the Act refers to asset-holdership. Section 1 *viz.* "nominee" uses the phrase "registered holder", rather than "owner", to describe the instrument-holder. The definitions of "securities", "securities register", "shareholder" and "uncertificated securities register" are all interpretively neutral: they contain no reference to "owner" or "ownership". In contrast, s 1 *viz.* "beneficial interest" *does* reference, inter alia, "ownership". Further, the overall objective of Part E of Chapter 2 of the Act seems further to support this view.[86]

In conclusion, it becomes very difficult not to conclude that "ownership" in the statutory context of the custody and administration of securities has retained its historic meaning and thus, under the scheme of this work, refers to asset-holdership. This has an important effect on the statutory ownership and transfer provisions of the FMA.

5 1 3 2 The nature of co-ownership

This brings one to the central issue – s 37 of the FMA and the construct of co-ownership.

As shown in the second part of Chapter 3 and in the preceding sections of this chapter, the process of legal development leading to the dematerialisation of securities was both gradual and iterative. Due to the predominantly Civilian nature of South African private law, a key facilitator throughout this process of development was the construct of co-ownership. It remains a core concept even in the

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85 See Chapter 9 generally for more on this topic.

86 The word "owner" or "ownership" appears in: s 49(6)(b), referring to transfer of ownership *by a CSDP* and s 50(2)(b)(iv)(bb), where the word ownership is *explicitly qualified* by the word *"registered"*, indicating an intention to distinguish its usage there from elsewhere; this is further supported by s 53 itself.

dematerialised securities environment, due to the primarily "indirect non-transparent" nature of intermediation in the system.[87]

This begins, again, with a look at the legislative development, presented below in a slightly different tabular format. Here there is also a strong terminological and conceptual path dependency in the carrying over of the co-ownership construct across the various Acts dealing with the custody and administration of securities:

Ownership and recertification (delivery)	
Custody and Administration of Securities Act	**4. Ownership of securities.** — (1) Where securities of any kind are deposited with a depositary institution or with a central securities depository, or accrue to securities held by such institution in a securities repository or by such depository in a central securities repository, the person who was the owner of the securities at the time of deposit or accrual shall become entitled to an interest as co-owner of all the securities of the same kind comprised in the securities repository or central securities repository, as the case may be. (2) In so far as any limited right exists in respect of any securities at the time of such deposit or accrual, such limited right shall extend to the interest of such co-owner and to any securities delivered to that co-owner. (3) The interest of a co-owner, client or participant in all the securities in a securities repository or central securities repository, as the case may be, shall be calculated with reference to the proportion that the number or nominal value of securities deposited by or on behalf of that co-owner, client or participant and accruing to such securities bears from time to time to the total number or nominal value of all securities of that kind held in the securities repository or central securities repository, as the case may be. (3A) Subsections (1), (2) and (3) do not apply to uncertificated securities. (4) A written acknowledgement signed by or on behalf of a depositary institution in respect of an owner of securities or of a client, or by or on behalf of a central securities depository in respect of a participant or client, as the case may be, and specifying the interest of that owner, client or participant, as the case may be, shall be prima facie evidence of the title or interest of that person in such securities.
Securities Services Act	**41. Ownership of securities**. — (1) Where securities of any kind are deposited with a participant or with a central securities depository, or accrue to the owner of securities held by a participant in a securities repository or by a central securities depository in a central securities repository, the person who was the owner of the securities at the time of deposit or accrual becomes entitled to an interest as co-owner of all the securities of the same kind comprised in the securities repository or central securities repository, as the case may be.

[87] Vermaas (2010) *Acta Juridica* 97 n 55, 99 & 103-104.

	(2) In so far as any limited right exists in respect of any securities at the time of such deposit or accrual, such limited right extends to the interest of such co-owner and to any securities delivered to that co-owner. (3) The interest of a co-owner client or participant in all the securities in a securities repository or central securities repository, as the case may be, must be calculated by reference to the proportion that the number or nominal value of securities deposited by or on behalf of that co-owner, client or participant and accruing to such securities, bears from time to time to the total number or nominal value of all securities of that kind held in the securities repository or central securities repository as the case may be. (4) A written statement issued by or on behalf of a participant in respect of an owner of securities or of a client or by or on behalf of a central securities depository in respect of a participant as the case may be, and specifying the interest of that owner, client or participant, is prima facie evidence of the title or interest of that person in such securities.
Financial Markets Act	**37. Ownership of securities.** — (1) Where securities of any kind are deposited with a participant or with a central securities depository, or accrue to the owner of securities of the same kind held collectively by a participant, authorised user, nominee or external central securities depository in a securities account or by a central securities depository in a central securities account, the person who was the owner of the securities at the time of deposit or accrual becomes entitled to an interest as co-owner of all the securities of the same kind comprised in the securities account or central securities account, as the case may be. (2) In so far as any limited right exists in respect of any securities at the time of such deposit or accrual, such limited right extends to the interest of such co-owner and to any securities delivered to that co-owner. (3) The interest of a co-owner in all the securities in a securities account or central securities account, as the case may be, must be calculated by reference to the proportion that the number or nominal value of securities deposited by or on behalf of that co-owner and accruing to such securities, bears from time to time to the total number or nominal value of all securities of that kind held in the securities account or the central securities account. (4) A written statement issued by or on behalf of a participant in respect of an owner of securities or of a client or by or on behalf of a central securities depository in respect of an owner of securities or of a participant, external central securities depository or other person as the case may be, and specifying the interest of that owner, client, participant, external central securities depository or other person, is sufficient proof of the title or interest of that person in such securities. (5) Any securities held by a central securities depository, participant or nominee for or on behalf of another person, must be segregated and identifiable as belonging to a specific person and are considered to be trust property as defined in the Financial Institutions (Protection of Funds) Act, and that Act applies to those securities.

At face value the co-ownership construct, as a feature of dematerialisation, remains embedded in the statutory regime, so that:[88]

> "the root of title to securities held with an intermediary in the CSD environment is the credit to a securities account. Furthermore, *unless the securities are segregated and individually registered on the relevant securities account*, investors in a particular issue of securities held by an intermediary (e.g. a nominee) in a common pool have co-proprietary interest in the pool."

Yet despite the explicit mention of "co-ownership" in s 37(1)-(3), s 37(5) stipulates that "[a]ny securities held by a central securities depository, participant or nominee for or on behalf of another person, must be segregated and identifiable as belonging to a specific person and are considered to be trust property as defined in the Financial Institutions (Protection of Funds) Act, and that Act applies to those securities." This raises a difficult tension *within* s 37 in that:[89]

> "[t]he proprietary consequences of a 'deposit' in regard to the investor's interest in the uncertificated securities is not clear because it is challenging to reconcile s 37(1) to (3) of the FMA with s 37(5) of the FMA and with other relevant provisions of the FMA and the Act. While in practice an investor is generally treated as if he is the beneficial owner of the deposited uncertificated securities, on the face of it, s 37(1) of the FMA provides that where the securities are collectively held in a securities account the investor 'exchanges' his beneficial ownership in the particular securities for an undivided pro rata co-ownership interest in all the uncertificated securities in the relevant securities account (referred to as the 'co-ownership interest interpretation')."

That tension has now been resolved through the outcomes of the previous section, allowing the discussion to focus solely on solving the question of the nature of the asset-holder's interest.

The first question that arises in understanding co-ownership is the nature and effect of the commingling. Specifically, one must ask whether a "natural" commingling, arising from the quasi-fungibility of securities of the same class and issue held collectively, is an emergent property of securities within the custodial system. Securities are regarded in principle as quasi-fungible and so in the context of holdership or sale a security of a particular class and issue, a security's patrimonial substance is fungible relative to other such securities. The outcomes of Chapter 4 now allow one to refer to holdership of that underlying substance with more precision – asset-holdership. This allows a critical distinction not evident in the current literature to be drawn: it is not the security which is fungible, nor the security instrument as a proxy for the security which is fungible, but the *patrimonial substance of the security* – i.e. the security asset – which is fungible, and fully so. The security asset – i.e. the locus of (holdership of) the incidents of enjoyment – as legal object in its own right is

88 Vermaas (2010) *Acta Juridica* 91 [own emphasis].

89 Yeats et al *Commentary 2008* 2-597.

identical for each security of the same class and issue, and is therefore on first principles capable of commingling *if* that has factually occurred. The importance of this observation cannot be overstated for the outcomes of the rest of this section.

Armed with the distinction between the quasi-fungibility of *securities* of a particular class and issue, and the full fungibility of security *assets* of the same class and issue, the question of whether a natural commingling of security assets is an emergent property of securities within the custody and administration system appears to answerable in the affirmative.

Historically:[90]

> "[i]n conceptualising a system of deposit for South Africa, Malan & Oosthuizen categorically state that a collective securities depository does not become the "owner" of the securities deposited with it or registered in its name. Investors become co-owners of the certificates held in collective deposit as well as joint holders of the body of securities held collectively. *The concept of co-ownership initially developed in relation to share certificates and draws on the law of things*, *based on which former owners of units mixed subsequent to a* confusion *become co-owners of the mixture,* whether they have consented to their mixing or not. This result has been approximated in statute."

However, it is submitted that this statutory approximation is merely confirmatory – it *regulates* rather than *enables* the commingling. In *First National Bank of South Africa Ltd v Perry NO and others*,[91] the SCA patently accepts the mixing of money existing only in the form of a personal right against a bank, thereby excluding the possibility of a vindicatory action. Therefore commingling of personal rights appears possible, and the notion that "the rules of the law of things do not apply because shares do not fall within the *numerus clausus* of rights that are acknowledged to be property"[92] can be challenged.[93] Coupled with the work in Chapter 4, specifically § 4 3 2 in demonstrating the more proprietary aspects of securities, one sees that the principle may apply in the current context also, and is comparable in that regard to money as a claim against a bank. Therefore, it is submitted that commingling of security assets is an emergent property of any securities that are "held collectively" in any given register-level securities account. As will be seen, this position is also a necessary

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90 Meissner (2019) 242 [own emphasis]. See also Yeats et al *Commentary 2008* 2-605.

91 2001 (3) SA 960 (SCA) para. [16].

92 Meissner (2019) 242 n 142, citing Vermaas *Aspekte van die Dematerialisasie van Genoteerde Aandele in die Suid-Afrikaanse Reg* (1995).

Malan *Collective Securities Depositories* (1984) 223 also seems to suggest the mixing is a naturally emergent property when securities are held collectively:

> "It is submitted that it is not possible to identify the securities of any particular client held by a bank in such "collective deposit". It therefore follows that the whole body of securities so held belong to the investors jointly, and that each investor is entitled to a proportionate share in the group of securities of that kind."

93 Though it is beyond the scope of this work, this work questions even the correctness of positing that there is a "*numerus clausus* of rights" acknowledgeable as property.

building block for coming to a sensible and consistent interpretation of the meaning of the phrase "held collectively", as found in s 37(1) of the FMA (and elsewhere).

This allows one to turn directly to s 37 of the FMA, specifically s 37(1). To best analyse the section, its language must be deconstructed into three constituent parts, after which its total import will become easier to deal with.

Securities of any kind

Section 37(1) begins as follows:

> "Where securities of any kind…"

This merely confirms that the section applies to all securities when subjected to the custody and administration system.

Deposit and accrual

The next two parts deal with the manner in which securities may be subject to the uncertificated securities system and therefore potentially to co-ownership – i.e. "deposit" and "accrual". Beginning with the former:

> "*deposited* with a participant or with a central securities depository, …" [own emphasis]

In light of § 5 1 1 and the inferred meaning of "accrue" as discussed below, this must refer to deposit as meaning: (1) the physical deposit of bearer securities and the corresponding creation of a secondary, representative registered security; or (2) the dematerialisation of certificated securities; (3) the immobilisation of certificated securities; or (4) the issue of securities in uncertificated form.

It is implicit from the scheme of the section that these depository actions will subject securities to the uncertificated custody and administration system, so that they will reflect in a CSD, and most likely also a CSDP, securities account. As a result, these securities form part of the uncertificated securities register, reflecting instrument-holdership in a securities account maintained for a particular client, or perhaps for a set of clients.[94]

However, the thrust of this element of the section appears to go further in providing that such deposit will cause the asset-holder to exchange full asset-holdership of the underlying securities for co-

94 Though the possibility of a securities account maintained for more than one client is not the preferred interpretation of this work, *Figure 4* provides a hypothetical example of a single securities account maintained for more than one client.

asset-holdership of the *bloc* of securities. It must be pointed out here that the phrase "held collectively" is not made use of for deposit as envisaged by s 37(1) – this will be dealt with after the next element of the section has been discussed.

The section continues:

> "or *accrue* to the owner of securities of the same kind *held collectively* by a participant, authorised user, nominee or external central securities depository, *in a securities account* or by a central securities depository *in a central securities account*…" [own emphasis]

This is the manner in which the securities which are already within the system may become subject to the co-ownership construct. "Accrue" must, due to the meaning ascribed to "ownership" and a subtraction of the various meanings of "deposit" already covered above, be a reference to the *transfer* or *transmission* (see Chapter 8) of asset-holdership to the transferee asset-holder (i.e. "owner"). It is not clear from the language whether the transfer or transmission must have the result of the securities in question being added to an existing amount of securities of that kind already (1) in the account in question, and (2) already owned by that "owner". It is submitted, based on what follows, that this is not a correct reading and instead it merely serves to indicate that the securities have accrued to an asset-holder ("owner") via entry in an account or number of (tiered) accounts.

This brings one to "held collectively…in a securities account…or…in a central securities account". Against the discussion in § 5 1 2 above, this should be read with reference to the *custodial* function. Of the intermediaries mentioned, i.e. CSDs, CSDPs, authorised users and nominees, only nominees are empowered to fulfil the *administrative* function of instrument-holdership for another. However, in the custodial capacity, all are able to maintain securities accounts for clients. This clearly indicates that the phrase is intended to cover the manner in which the securities are *custodially* held.

What then is the import of the qualification "held collectively" as in s 37(1)?

It is submitted that the answer is quite simple: it is a qualification for the effect of s 37(1), which (perhaps more importantly) ensures the operation of s 37(3). This latter subsection (dealt with below in more detail) prescribes the manner in which a co-ownership interest must be calculated and further supports a number of key insolvency and securities-shortfall risk mitigation measures, such as loss-sharing arrangements, within the system. The correct application of these controls appears to hinge on whether securities are held collectively, which is evidently sensible.

More specifically, therefore, the qualification "held collectively" should be read as a factual precondition that must be present for the application of the co-ownership dispensation. It is submitted that this factual precondition, given the history of the section and indeed of the system in South African law, is simply the *commingling* of the security assets. It follows that the final element of s

37(1), as discussed below, does not impose co-ownership – it confirms co-ownership when the precondition is met, enabling the operation of further rules and controls, such as s 37(3), loss-sharing, or shortfall determination and allocation. Therefore, one must determine whether commingling occurs, as that will determine whether the securities are held collectively.

The approach to this determination under the current iteration begins, as mentioned in § 5 1 2 1 above, with the removal of the "repository" concept, so that "the entitlement in s 37(1) is with reference to 'securities of the same kind comprised *in the securities account or central securities account*, as the case may be' as opposed to 'all the securities of the same kind comprised in the *securities repository or central securities*'".[95] According to the *Explanatory Memorandum to the Financial Markets Bill*, the decision was "to remove the reference to "repository", as the term creates legal uncertainty".[96] This makes it clear that a determination regarding commingling must be made on the basis of the state of affairs of *all* relevant securities accounts, which according to the language used includes the accounts of CSDs, CSDPs, authorised users and nominees.

Nonetheless, this work is also in agreement with the following statement:[97]

> "The Financial Markets Act does not clarify at which level of intermediation this co-ownership interest must be determined, referring only to co-ownership "of all the securities of the same kind comprised in the securities account or central securities account, as the case may be". The definition of "securities accounts" includes accounts kept by nominees for their clients and is therefore so wide that its ambit appears to found a co-ownership interest at every tier of intermediation. This would result in a duplication of co-ownership interests. The principles of property law do not, however, permit more than one person to be owner of the same asset at the same time. Rather, the co-ownership interest should be calculated *with reference to the positions recorded in the records that constitute the uncertificated securities register*."

A better understanding of the nature of securities (as per Chapter 4) and the system of accounts (as per § 5 1 2 above) allows one to reconcile: (1) the taking into account of the state of securities accounts at all levels, with (2) the notion that commingling must occur at register-level, and in so doing one is further able to develop an appropriate test for commingling.

It is uncontentious that the schema of the FMA does not preclude a custodial system, or practice within such a system, in which there are "global"[98] security instruments – i.e. *an entry* reflecting an

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95 Yeats et al *Commentary 2008* 2-605 [authors' emphasis].

96 National Treasury *Explanatory Memorandum to the Financial Markets Bill of 2011*, § 34 at 39 (dealing with the "Ownership of securities" clause of the Bill, which is now taken up in s 37 of the FMA).

97 Meissner (2019) 244 [own emphasis].

98 Global in the sense of having a single instrument for many assets, as first arose in immobilisation systems (for both bearer-based jurisdictions and later also for the early South African, register-based, system) – see Chapter 3, § 3 2 1 & 3 2 2.

instrument-holder of *a number* of securities of the same kind. Further, the South African system is mainly a non-transparent one.[99] Thus a typical entry in a central securities account or any securities account, as defined in s 1, that is kept for a downstream client (see *Figure 2*) has three informational functions that are important for these purposes. It must provide: (1) by entry, the identity of the instrument-holder, (2) how many securities of each kind she or it holds; and (3) the identity of the *client* for whom the securities is maintained. Equally importantly, what it formally need not reflect is the identity of the asset-holder, as the client for whom it is kept may not be that end-of-chain asset-holder (see *Figure 5*, as read with *Figures 1* and *3* as an example).[100]

Security *assets* of the same class and issue are fully fungible, and so one determines the extent of the co-asset-holdership of any end-of-chain investor in terms of ss (3), which hinges on a calculation using the "number or nominal value" of securities held by one instrument-holder in relation to the total number which is held by all instrument-holders in the securities account in question. This is key, because even where an individual securities account is maintained by a CSD in the name of a client (such as the so-called "SDA" own name registration option offered by Strate Ltd), and that account is therefore not truly an omnibus account, that client may still hold securities (i.e. be instrument-holder) as nominee for a number of end-of-chain asset-holders.[101]

Therefore the fungibility of the security *assets* of each respective class and issue of securities, as indicated by the security instrument(s) of those securities (which are not patrimonial legal objects), is an important enabling characteristic of co-asset-holdership within this system. Briefly, the uncertificated instrument may not indicate individual securities, but will always *demarcate* the "number or nominal value" of security assets for which it contains the incidents of execution.

Thus, it is suggested that securities are held collectively when: (1) a state of affairs at *any level* of securities account within the system (i.e. maintained by CSD, CSDP, nominee or authorised user) prevails, (2) with the effect that a specific entry in a *register-level* account reflects instrument-holdership for more than one asset-holder. Where a single instrument-holder fulfils the administrative function for more than one asset-holder, the fungible bulk of security assets corresponding to the (global) register entry must naturally have commingled, because any *bloc* of security assets held by an asset-holder can no longer be allocated to a specific *bloc* of security instruments (regardless of the instruments' serial numbering) on the uncertificated securities register. In such cases, the assets

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99 See Vermaas (2010) *Acta Juridica* 99 & n 66, as well as 95-97, and Meissner (2019) 223 & n 22.

100 See also Meissner (2019) 244:

> "Even if the determination of co-ownership takes place at the level of uncertificated securities registers, co-ownership vests in the investors, not in the shareholders acting as nominees. The entry at register-level determines both the numerical proportion of an investor's interest and facilitates a transfer thereof, but without necessitating that the entry be made in the name of the co-owner."

101 See for example the discussion and figure in Yeats et al *Commentary 2008* 2-989 2-991.

must be held *collectively*. To illustrate the degree of complexity, but also the appropriateness of the proposed approach for the precondition of commingling (and consequent application of the co-ownership dispensation), consider the following representation of holdership of securities of the same class and issue, in this case the securities of ABC Ltd, within a custodial system:

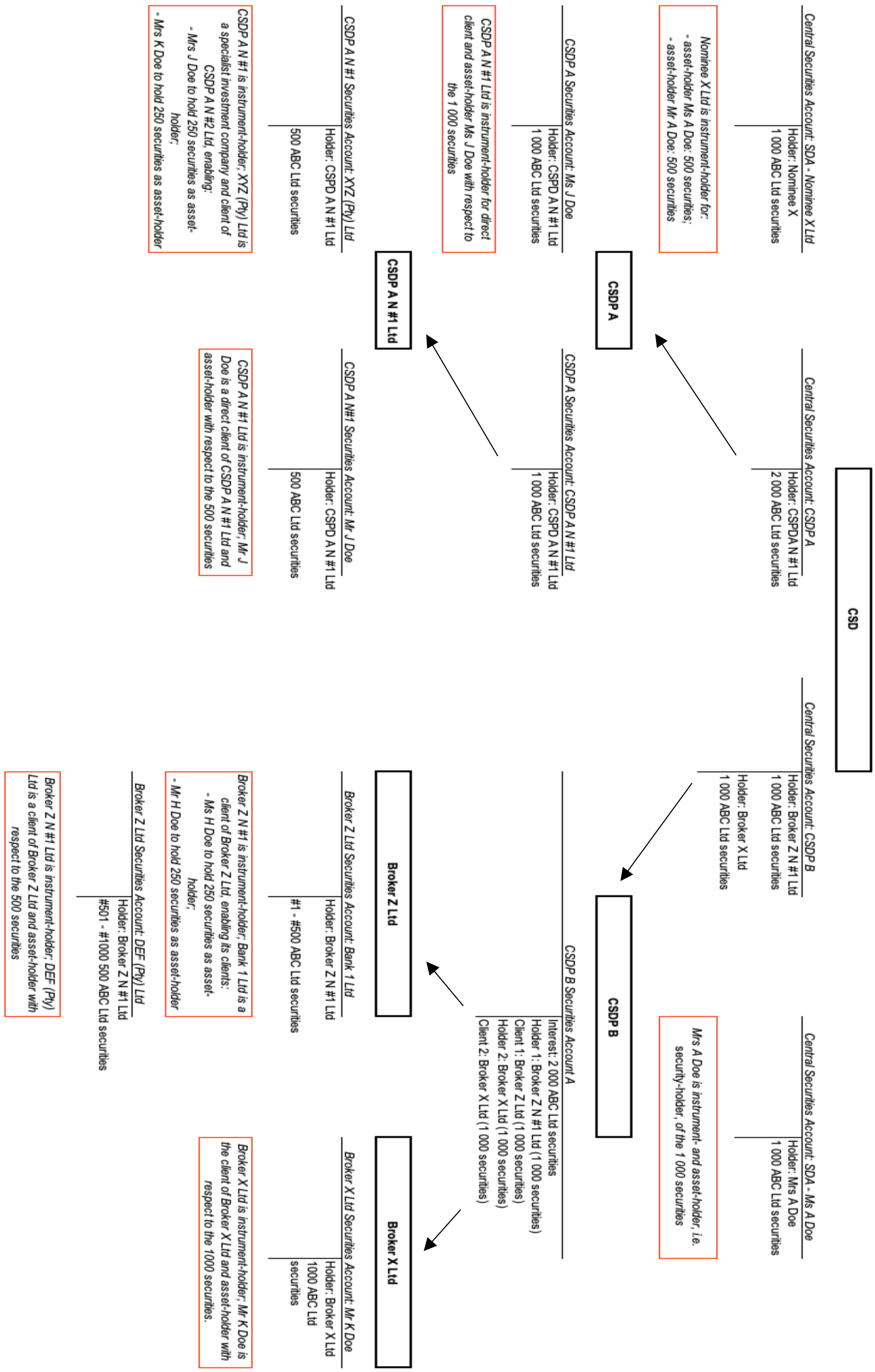

Figure 7: various permutations of security-holdership within the custody and administration system ("holder" in the securities accounts denotes instrument-holder*)*

This illustration demonstrates that there are a large number of ways that security assets are able to commingle, and therefore should be regarded as being held collectively.

In terms of the two own-name CSD accounts, one can make the following observations. The security assets of Mrs A Doe have not commingled, as she holds *security*-holdership via (to use the terminology adopted by Strate) an SDA account in own name. Yet the asset-holdership of Ms A Doe and Mr A Doe has commingled, despite the fact that Nominee X Ltd holds an SDA account, because it is only the instrument-holder, acting for more than one asset-holder, and holds the securities in a manner that does not enable the allocation of either asset-holder's interest to a specific *bloc* of security instruments.

In terms of the CSDP A, the following positions would apply. Ms J Doe's security assets have not commingled. She is a direct client of CSDP A, and her security assets are directly attributable to a specific *bloc* of security instruments (held, in terms of the administrative function by CSDP A Nominee # 1 Ltd) *on the uncertificated securities register*, albeit through the granularity provided on CSDP A's subregister rather than the CSD's central securities account maintained for CSDP A. However, the same cannot be true of the non-register level accounts maintained by CSDP A Nominee # 1 Ltd. Here the security assets – of Mrs J Doe, Mrs K Doe and Mr J Doe – have already commingled at register-level, as their respective holdings are not directly attributable to the *bloc* of security instruments on the subregister maintained by CSDP A for CSDP A Nominee # 1 Ltd. Interestingly, in the case of the non-register level securities account maintained for client XYZ (Pty) Ltd, the respective, specific interests of Mrs J Doe and Mrs K Doe are also not reflected in the securities account. This may have further implications for security of transfer, shortfall allocation and insolvency protection, but this is *not* because they are held collectively by CSDP A Nominee #1 Ltd. It is because there is a further subdivision of interests that has occurs outside of the custody and administration system.

One may now turn to CSDP B. Here the central securities account reflects two different instrument-holders and is therefore in line with the duty of segregation imposed by the FMA. The securities account maintained by CSDP B is maintained in a manner that is not favoured by this work, but is nonetheless included.[102] On Strate's interpretation, these securities are no doubt held collectively. However, on closer inspection, one sees that the state of affairs in the *non-register level* securities accounts will in fact determine whether the asset-holdership of each underlying investor is attributable to a *bloc* of security instruments at register level. The asset-holdership of Mr K Doe is

[102] See the discussion in § 5 1 2 4 above as illustrated by *Figure 4.*

quite clearly attributable to the *bloc* of security instruments administratively held by Broker X Ltd – therefore no commingling has taken place, and the securities cannot be said to be held collectively. On the other hand, the asset-holdership of Mr H Doe, Ms H Doe and DEF (Pty) Ltd has been further subdivided below register level. Yet, unlike the case of the securities accounts kept by CSDP A Nominee #1 Ltd, the securities accounts of Broker Z Ltd contain an indication of which securities, as administratively held by Broker Z Nominee #1 Ltd, are kept in each account for the client of that account. Therefore, one can determine that asset-holdership of the security assets of DEF (Pty) Ltd is attributable to a specific *bloc* of securities in the uncertificated securities register, and therefore are *not* held collectively. The same cannot be said of the holdership of Mr H Doe and Ms H Doe – these securities are held collectively, because although Broker Z Nominee #1 Ltd is instrument-holder of a specifically allocated number of securities for its client Bank 1 Ltd, the respective security assets held by the end-of-chain investors are not attributable to a specific *bloc* of security instruments on the uncertificated securities register.

However, in its *Guidance Note on the Loss Sharing Mechanism In the Strate Environment*, Strate appears to be of a slightly different view. This is a good test case for what is suggested here. For the application of the loss-sharing mechanism, the guidance note must explain what is meant by "held collectively" (which will determine the clients affected by the "loss-sharing mechanism" in cases of shortfalls in CSDP insolvency proceedings). It provides that this is the case when:[103]

> "*clients…*are holding securities collectively in a securities account *together with other securities holders*….[so that w]here securities of an issue are not held collectively in an omnibus account, but allocated to only one client and there is a shortfall in that account, that client bears the entire risk of the shortfall.
>
> …
>
> [Contrastingly, where] a client holds securities in his/her/its own name on the subregister (legal record of ownership held and maintained by the CSD Participant) or a segregated depository account, such as the Segregated Depository Accounts ('SDAs') the securities are individually identified and segregated.
>
> However, where a client holds securities not in his own name but under the name of a nominee on the subregister, the securities of that client are not individually identified and segregated on that subregister held and maintained by the CSD Participant."

With respect, this explanation conflates the custodial and administrative functions in relation to the client-concept, most importantly in that the first sentence equates the position of a "client" with that

103 Strate (Pty) Ltd *Guidance Note on the Loss Sharing Mechanism In the Strate Environment* Special Gazette S17-2015 (3 November 2015), paras. 3 & 4 [own emphasis].

of an instrument-holder ("other security holders"), and that the final two paragraphs equate the position of a "client" with that of an asset-holder. It has already been shown that clients, asset-holders and instrument-holders can be different actors with different roles within the system of accounts.

The more functional view, which remains in keeping with the purposive thrust of the guidance note, is to posit, as above, that securities are held collectively when instrument-holdership in the register-level (CSD and CSDP) securities accounts, *maintained for a specific client*, is held for more than one underlying asset-holder in a manner that does not allow one to link the interests of a specific asset-holder to a specific *bloc* of security instruments. In such cases the interests of the respective asset-holders cannot be allocated to the specific interests of the instrument-holder, have thus commingled, and must be subject to the loss-sharing mechanism. Thus this work differs from the *Guidance Note* on when securities are held collectively, but is aligned to it in terms of the consequences of securities that are held collectively.

Thus, on the view suggested, it will remain true, as set out by the Strate *Guidance Note*, that: (1) where securities are "allocated to only one client" or "[w]here a client holds securities in his/her/its own name on the subregister or a segregated depository account" the loss-sharing mechanism will not apply; and (2) also that "where a client holds securities not in his own name but under the name of a nominee on the subregister [or in an SDA account]" the loss-sharing mechanism will apply, *but* only in those cases where the nominee is instrument-holder with respect to more than one underlying asset-holder. The approach suggested therefore has similar outcomes, but is on sounder conceptual footing.

Co-ownership

Finally, s 37(1) provides:

> "the person who was the *owner* the securities at the time of deposit or accrual *becomes entitled to an interest as co-owner* of all the securities of the same kind comprised in the securities account or central securities account, as the case may be."

This is not, as it first appears, merely a reference to the moment of dematerialisation; instead, it is a reference to the moment when a security *instrument* "joins" a particular register-level securities account and a new co-ownership dispensation – as per s 37(3) – begins to apply. Thus it may be applied to securities introduced into the uncertificated system as well as to securities, already within that system, that are transferred.

The only remaining problem is that "deposit" into the system is not qualified by "held collectively" in the same manner as "accrual" within the system is. There is, based on the above, little sense in this omission and it is submitted that until statutory intervention occurs to clarify or rectify this, it (and therefore the factual prerequisite for commingling) must be read in. It does not make sense, where securities are deposited into an *own-name* SDA account, that the plain language import of the section is that such securities will be subject to co-ownership. The client, as *security*-holder, will not on first principles exchange an ownership interest for a co-ownership interest. Neither can this be the case when securities are deposited with a CSDP by a direct asset-holder client who takes instrument-holdership in her own name.

Summarised in plainer language, s 37(1) essentially stipulates that at any moment when securities (1) become *subject to* (thorough "deposit" as read above), or (2) have (through "accrual" as read above) *moved around within* the system of custody and administration of uncertificated securities, (3) in a manner that has caused the security assets to *commingle at register-level*, then (4) the securities are held collectively and the asset-holder ("owner") becomes co-asset-holder of her portion of the security assets demarcated by an instrument-holder's total holdership in the uncertificated securities register.[104]

5 1 3 3 Alternative perspectives: **Commentary 2008**

Finally, it is necessary to deal specifically with the alternative perspectives articulated in *Commentary 2008*. The work offers a singularly detailed, erudite and compelling analysis of the uncertificated system in its discussion of *Part E* of the Companies Act of 2008 ("Introduction to and overview of Part E of Chapter 2"), specifically under "(4) Uncertificated securities", "(5) History of uncertificated securities and immobilisation", and "(6) Separation of ownership and registered title".[105] More importantly for present purposes, these outcomes are then used by the authors as a basis for offering a more detailed and excellent analysis, discussed under s 49(3) of the Act, of various (somewhat competing) views on the "Nature of the custodial holding of uncertificated securities".[106]

It is not necessary (or possible) to deal with this lengthy exposition in great detail. What must, however, be discussed are the two most compelling views offered – the "co-ownership interpretation", which is favoured by the authors; and the "dual ownership interpretation". What is

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104 See the following in Yeats et al *Commentary 2008* at 2-605 regarding a critical difference between the FMA and earlier iterations of the dematerialisation system:

> "the co-ownership interest in s 37(1) of the FMA applies to 'securities of the same kind *held collectively* by a *participant, authorised user, nominee or external central securities depository* in a securities account or by a central securities depository in a central securities account' as opposed to having application to *all securities* of the same kind deposited with or held by 'a depositary institution or with a central securities depository'. Second, the entitlement in s 37(1) is with reference to 'securities of the same kind comprised *in the securities account or central securities account*, as the case may be' as opposed to 'all the securities of the same kind comprised in the *securities repository or central securities repository*'."

105 Yeats et al *Commentary 2008* 2-517 – 2-590.

106 Yeats et al *Commentary 2008* 2-596 – 2-644.

most encouraging about the work of Chapter 4 and this Chapter is that it is seemingly able to deal with many of the material challenges outlined by each of these interpretations by harmonising the two and consequently accommodating each of their key useful attributes.

The co-ownership interpretation:[107]

> "reads s 37(1) as providing that when securities are dematerialised, the investor 'exchanges' by way of law (rather than contract) his beneficial ownership of the particular deposited securities for an undivided co-ownership interest in all the uncertificated securities of the same kind held collectively in the relevant securities account. This construction is favoured based on the genesis and evolution of the legislative provisions regulating uncertificated securities.
>
> …it is apparent that the explanatory memorandum to the Bill introducing the Safe Deposit of Securities Act, 1992 generally continues to apply to s 37(1) with reference to collectively held securities. Accordingly, the historical genesis and evolution of the provision and the original expressed purpose of the provision ineluctably leads to the conclusion that s 37(1) is directed at rendering the depositor a co-owner of collective holdings, which favours the co-ownership interest interpretation."

The first of three main challenges to this interpretation, according to the authors, is the import of s 37(5) and other provisions which appear to be contra-indications to co-ownership, and which pose various interpretive issues that are then discussed by the authors.[108] The preceding analysis of this chapter, specifically § 5 1 2 and § 5 1 3, adequately resolves this issue through its approach to the meaning of "belonging" and its reading of the definition of trust property in s 1 of the FI Act as applicable to the custodial and administrative functions *separately*. Thus the discussion does not require specific treatment here.

The second challenge is the problem of "different levels of co-ownership", in terms of which:[109]

> "the account specific determination complicates matters, with a multiplicity of possible permutations in the event of a shortfall in one of the accounts. So if there is a shortfall (e.g. 10 shares) in a participant's subaccount, the co-ownership is reduced proportionately between the investors reflected in the relevant participant account (e.g. if the account reflected a total of 100 shares but there were in fact only 90 shares, each interest is reduced by 10%), but if this shortfall of 10 shares arises in the sole central securities account, the interests of the investors will be reduced proportionately between all the investors holding uncertificated securities reflected in that wider account (e.g. if there were 1 000 shares reflected but there were in fact only 990 shares, each interest is reduced by 1%). How these differing proportions will be reconciled is unclear…It is submitted that it makes sense to read the provision as taking into account the

107 Yeats et al *Commentary 2008* 2-605.

108 Yeats et al *Commentary 2008* 2-607 – 2-609.

109 Yeats et al *Commentary 2008* 2-610, and 2-610 – 2-611 for the full discussion.

> 'hierarchy' and work from the 'top-down' to the securities account reflecting the investor's interest, apportioning any shortfalls in any 'collective holdings'."

The preceding section, and its approach as to when securities should be regarded as being held collectively, allows this issue to be easily resolved. The shortfall mechanism will apply to all asset-holders (1) whose securities are held collectively, and (2) who are affected by a shortfall. In that sense the suggested approach in the last sentence above is correct when taking into account the proper meaning of "held collectively".

Third is the problem of references elsewhere in the FMA to direct ownership. Here the authors remark:[110]

> "The FMA appears to contemplate a two-headed Ettin, with different faces for different purposes. On the one hand, it wants to spread the risk between investors in respect of collectively held uncertificated securities by way of investors holding co-ownership interests, but on the other hand, it wants to facilitate the investor's control over the specific securities deposited (or subsequently acquired). To achieve this, it would be necessary to somehow read the provisions as implying that the co-ownership interest is regarded as represented by a pro rata registered holding of the designated securities held in custody, with the relevant investor being empowered (through the relevant chain of mandates read together with the FMA) to control the exercise of the rights attaching to the relevant pro rata number of securities (often only reflected in an approved nominees sub-subregister), as if he were the owner of such securities."

Again, the asset and instrument construction, coupled with the preceding analysis regarding: (1) the manner in which to interpret the phrase "segregated and identifiable as belonging to a specific person", (2) the correct reading of "owner" (as asset-holder) vis-à-vis "client", (3) the precise understanding of the import of the FI Act, and (4) the import of "held collectively", resolves most, though again not all, of the difficulties that may arise here.

The last main challenge is the "lack of clarity regarding depositories"[111] and the implications of the import of a putative deposit of something which is then deemed "trust property" under the FI Act. The work done in this chapter regarding the custodial system and a sound understanding of the distinction between the custodial and administrative functions, especially in the context of the FI Act, makes the depositories' legal position quite clear.

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110 Yeats et al *Commentary 2008* 2-617, and 2-611 – 2-618 for the full discussion.

111 Yeats et al *Commentary 2008* 2-618 and further discussions elsewhere in the work referenced therein.

The dual ownership interpretation on the other hand (quoted below at some, but on balance necessary, length) posits an entirely different approach to the underlying nature of "beneficial ownership" and "registered "holdership". It:[112]

> "regards the persons credited as the holders of securities in a securities account (or at least those securities accounts constituting the uncertificated securities register) as having 'legal ownership' of the relevant securities, and where the investor is not the holder of the registered title, to regard him as having a beneficial ownership interest by virtue of the securities being held in trust by the registered holder for the benefit of the beneficial owners. Such a reading would be based on a marrying of the provisions of s 4 of the Financial Institutions (Protection of Funds) Act 28 of 2001 with the concept of entries in the uncertificated securities register effecting transfers of ownership in terms of s 53(2). That is, s 37(5) is read as introducing, by way of a statutory trust arrangement, a form of dual ownership comparable to that applicable under the English law. Section 37(1) can then be married with s 37(5) by reading s 37(5) as requiring the client's 'legal ownership' of specific securities reflected in the relevant securities accounts to be segregated and where s 37(1) is applicable, the 'legal ownership' reflected in the securities account is then held in trust for the benefit of the beneficial co-owners contemplated in s 37(1).
>
> This interpretation is predicated on a reversal of the argument that, because registered title and beneficial ownership are severable, s 53(2) of the Act cannot be read as contemplating entries in the uncertificated securities register effecting transfers of the ownership interests. Instead, it resolves this dilemma by asserting that because s 53(2) of the Act requires ownership to be transferred by way of entries in the uncertificated securities register, this implies that a separation of the ownership interest from the registered title is precluded. M Vermaas appears to adopt such a construction. She states:
>
>> 'As indicated above, South Africa modernised its securities ownership and transfer laws through the enactment of s 91A of the old Act to ensure that holders of securities on the various subregisters have property rights in such securities. However, in practice, the majority of shareholders are recorded in sub-subregisters [i.e. a nominee securities account] in a lower tier which is not recognised in law as the *prima facie* record of legal ownership. *Only "own name" clients and nominees (the holders in name on the subregister) enjoy "full" legal ownership (including membership) rights vis-á-vis the issuer in the multi-tiered system*.'
>>
>> Many shareholders prefer to retain full legal ownership of securities which they hold, thus gaining automatically all the benefits of maintaining a direct relationship with the issuer. The legal concept of full legal ownership cannot automatically be applied in the multi- tiered indirect holding system, unless the beneficial holder is recorded as the full legal owner at the upper tier, such as the [central securities depository].' (footnotes omitted and emphasis added)
>
> This is taken further in *South African Corporate Business Administration* where it is stated (presumably by M Vermaas and/or A Henderson as the contributors):

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112 Yeats et al *Commentary 2008* 2-623 – 2-625, citing JG Van der Merwe, RB Appleton, D Mahoney & M Koen *South African Corporate Business Administration* (2000), and see 2-623 – 2-630 for the full discussion.

> 'The subregister reflects legal ownership. Where the securities are held in the name of a nominee, the nominee's name will be recorded in the *subregister as the legal owner*, not the beneficial owner. The Companies Act allows both "own name" registration and "nominee" registration for securities (section 56(1)), but it is clear that where the nominee is holding securities on behalf of a beneficial holder, the *latter's name cannot also be entered in the subregister as legal owner*.' (emphasis added)

R Rachlitz supports such a reading by stating:

> 'As the uncertificated securities register *also allocates ownership*, it can be said that, contrary to certificated shares, in the case of uncertificated shares ownership and registration cannot be separated from each other'. (emphasis added)

Unfortunately, Rachlitz does not provide further reasoning for this conclusion. It is submitted that the Act and the FMA continue to recognise the possible separation of beneficial ownership and registered title, and the abovementioned view does not appear to accord with the agency relationship between a nominee and a beneficial owner under South African law."

It is here where the work of Chapter 4 and this Chapter truly enables a useful merging of the better elements of these two interpretations. It supports the split (between asset- and instrument-holder) in a manner that accords with South African private law, making the need to use the FI Act to "simulate" a constructive trust entirely unnecessary (and in doing so renders all *consequent* interpretive problems, as discussed by the authors, moot). It therefore provides the two key advantages of the interpretation – simultaneous transfer of the instrument- and asset-holdership, as well as netting in the clearing and settlement system[113] – whilst preserving most of the advantages of the co-ownership interpretation.

The authors thereafter list a number of reasons why the dual ownership approach is not favoured. Many of these are now simply dealt with because the duality is no longer premised on s 37(5) or reading a constructive trust into South African law. The issue of the wording in s 39(1)(a) is dealt with in the discussion of cession *in securitatem debiti* of uncertificated securities found in § 8 5 of Chapter 8. However, shortly, one must read the entry of the cessionary in the securities account as *both* an exception to the norm of not reflecting patrimonial interests in a securities account, *and* a formality requirement. The issue of s 53 of the Companies Act revolves around quasi-delivery, and it indeed must be so that register entry *sine iusta causa* would not reflect the true owner, but the security asset is transferred to her nonetheless by operation of law (see § 8 2 2 of Chapter 8).

Finally, the authors argue that "even if registered title constituted 'legal ownership', this would require the central securities depository to ensure that the securities accounts in the central securities register are segregated down to a registered title level and collective central securities accounts

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113 Yeats et al *Commentary 2008* 2-627 – 2-628.

could not reflect a collective participant holding for more than one registered holder of securities, unless one argued that each level of securities account in the custodial model is a different level of "legal ownership", which would amount to a triple-tier ownership model (possibly based on a series of trust relationships), which appears to be a stretch too far."[114] This argument does not make sense once one adequately distinguishes the custodial and administrative functions, and is aware that depositories do not have any proprietary interest in securities (unless also acting as instrument-holders). Register-level securities accounts will always reflect a specific instrument-holder, even if it is a "global" register entry evidencing instrument-holdership for many asset-holders.

Therefore, to conclude, the security asset and instrument are only slightly modified by the uncertificated regime. Under the current system, the uncertificated security instrument indicates holdership of the incidents of execution over the "number or nominal value" of the security assets it so demarcates. This is not in principle so different from earlier system iterations, or even from the certificated system, where an instrument-holder may serve as the nominee for multiple asset-holders. However, by properly distinguishing in the interpretation of the words "held" and "hold" between the custodial and administrative functions as they have emerged (especially in relation to securities accounts), the entire scheme of the FMA becomes less difficult to understand and one is better able to identify provisions aimed at regulating the maintenance of securities accounts and those aimed at regulating instrument-holdership.

When security assets are held collectively, the effect of the system on them is more pronounced. Asset-holdership, when the security assets are commingled, becomes pro rata *co-holdership* of the incidents of enjoyment associated with the *demarcated* number of securities in a specific securities account. This is, economically, still the equivalent of holdership of a number of individual security assets. Yet the commingling has additional legal effects. Most importantly, the incidents of execution held though uncertificated instrument-holdership are no longer incidents that exist with reference to a particular individualised set of (the patrimonial) incidents of enjoyment. Instead the instrument *demarcates the extent of an asset-holder's holdership of the patrimonial incidents* of a larger pool of fungible security assets indicated by register-level account entry.

Finally, proof of the extent of the asset-holdership which an instrument demarcates (but taking into account the effect of finality of transfer) remains an evidentiary issue. With these slight modifications, one may apply all outcomes of Chapter 4 to uncertificated securities, including the observations regarding the proprietary aspects of securities, the objectification and holdership of individualised incidents, as well as the content and dynamics of the relationships between issuers, instrument- and asset-holders.

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114 Yeats et al *Commentary 2008* 2-630.

5 2 The *interests in securities* concept (and cross-border intermediation)

Thus far in this work the term "interests in securities" has been used to denote *limited real interests* held in respect of securities.[115] However, in the context of the international securities markets, the term "interests in securities" is used to convey another, very different meaning.

In the most authoritative work on this subject, *Interests in Securities: A Proprietary Analysis of the International Securities Markets*, J Benjamin defines this concept as "the assets of a client for whom an intermediary holds securities (or interests in securities) *on an unallocated basis*, commingled with the interests in securities of other clients."[116]

This particular meaning, and the question of its place and application in South African law, has the potential to cause conflict with the meaning attributed to the phrase elsewhere in this work (especially in § 8 5 of Chapter 8). Furthermore, crucially, the phrase "an interest in uncertificated securities", or a variation thereof, is used a number of times in the FMA, most notably in s 37-39, as well as in s 51(5) of the Companies Act, which is incorporated by reference into s 53, and thus similarly brought into the scheme of the FMA by s 38(1)(a) of the latter.

In that light, a key question is whether this phrase in the FMA may be intended to denote the international meaning outlined by Benjamin above, and to what extent. Is it correct that "the general impression is that in a number of instances it references 'uncertificated securities' interchangeably with 'interests in uncertificated securities' or specifies both out of an abundance of caution, rather than as a result of technical exactitude"?[117]

A further question then becomes to what extent this may cause disharmony in the terminological system established thus far in this work.

This section will attempt to harmonise the two meanings and integrate this concept into the broader terminological and theoretic framework established here for the legal analysis of securities.

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115 See Chapter 4, § 4 3 1 and § 4 3 2.

116 Benjamin *Interests in Securities* 5 [own emphasis]; see also at 30 – "This legal analysis informs the drafting of the revised article 8 of the US Uniform Commercial Code. Legislation in Belgium and Luxembourg takes the same approach, which accords with article 9(2) of the Settlement Finality Directive [Directive 98/26/EC] in relation to conflict of laws issues."

Benjamin's *Interests in Securities* is unusual in the sense that it consolidates a number of different sources from different fields on the subject matter, deriving a number of unique insights, explanations and conclusions from those sources, as well as from the author's consultation with industry professionals. There are also no authoritative sources which provide a comparable South African law perspective on these issues. On that basis, together with its evident quality, Benjamin's work will – and indeed must – be used as the primary source of reference for this section. Any synthesis of its content from further sources will require more effort than the value it adds.

117 Yeats et al *Commentary 2008* 2-614.

It begins with the international notion of interests in securities, focusing on English law registered securities. Benjamin outlines the basic elements of this concept (in the broader context of its application to, and place within, English law) as follows:[118]

> "interests in securities are legally distinct from securities…The distinction between securities and interests is often overlooked in practice…this is a source of legal risk.
>
> …[T]he interests of the participant in unallocated settlement and custody arrangements are not the same assets as the underlying securities.
>
> …the asset of the participant is different from the asset of the depositary. *The economic value of the former derives from the latter, but the two are legally distinct*.
>
> Interests in securities are often heavily intermediated, with a series of custodians, depositaries and other intermediaries *standing in the chain of ownership* between the investor and the underlying issuer. The investor may be further removed from the underlying issuer where its asset has been repackaged under securitisation, depositary receipt or investment funds arrangements.
>
> …Normally, each link in such a chain shares the characteristics of *unallocated settlement,* in that the interest of the client is *indirect, unallocated,* and *intangible*.

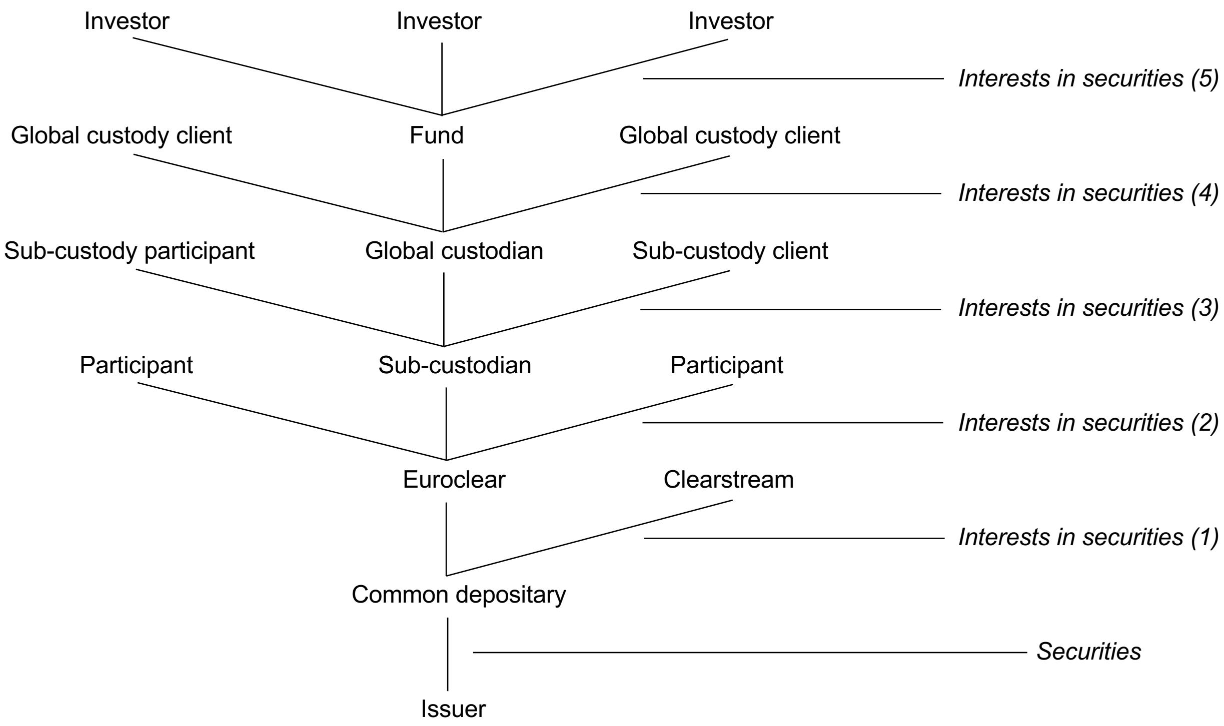

Figure 1.2: Chain of interests in securities

118 Benjamin *Interests in Securities* 3, 5, 28-30, 36-37 & 39 [own emphasis; own paragraphing].

> Although the underlying securities and the interests of the investor are legally distinct, they are the same in economic terms (on the basis that the investor's asset is not at risk in the event of the insolvency of any intermediary). In economic terms the holder of interests in securities has all the risks and rewards of ownership of the underlying securities. [Securities] may be tangible…or intangible…In contrast, interests in securities are always intangible. The only evidence for them comprises electronic records (i.e. positive balances in the client securities accounts maintained by the relevant intermediary)…An important consequence of the intangible nature of interests in securities is that they are incapable of possession at common law…Choses in action cannot be possessed…Interests in securities *confer on their holders rights of property in relation to the underlying securities*. However, they only do so *indirectly*, *as against the intermediary* in whose account the interests in securities are recorded."

An analysis of these issues is best broken up into two parts. The first is whether, and how, this concept may find any domestic application – i.e. whether one can speak of interests in securities as meant above in the context of domestically issued *and* held securities. This requires discussing some of the key differences between English and South African private law. Thereafter, the same question must be posed with respect to securities held in South Africa but issued abroad, or vice versa.

Beginning with this first question, the point of departure of the analysis must be the defining characteristics of "interests in securities". As seen above, these interests in securities are *intangible, indirect*, and *unallocated*. As a starting point for the present analysis, then, uncertificated domestic securities should be tested against these attributes (taking into account any pertinent differences between the South African and English legal systems).

First, are South African securities intangible? Yes – it is entirely trite that securities (other than domestically rare bearer securities), are intangibles (or rather *incorporeals*) in South African law.

Second is the question of whether uncertificated securities-holdership in South Africa is indirect. With respect to the Securities Services Act (the antecedent of the currently operative FMA), one finds the following statement by Vermaas:[119]

> "In contrast to the era when securities were held directly by their owners in physical form (the so-called 'direct' securities holding systems), most market players today hold their securities positions through intermediaries (e.g. participants, brokers, global custodians) in various different holding patterns…The difference between direct and indirect systems can be defined by reference to the presence or absence of a direct link between the issuer and the investor.
>
> The indirect holding system that was introduced in the 1970s to cope with the worldwide paper explosion as trading volumes increased has also been in use in South Africa for many years. The operation of

[119] M Vermaas "The reform of the law of uncertificated securities in South African company law" (2010) *Acta Juridica* 87 94-95.

> omnibus accounts or global accounts generally reduces the cost of holding securities and makes it easier for market participants to transfer securities, thus increasing the liquidity of securities positions. The business of custody was invented during this time and as a consequence great reliance was placed on the intermediary to maintain proper records. With every added tier holding securities for the investor, the issuer became more and more dis-intermediate from its shareholder."

The question can therefore be refined so as to ask whether this "dis-intermediation" makes the held interest also indirect.

In terms of the current iteration under FMA, the previous section demonstrates that it remains the case that when securities are held collectively, "[i.e.] unless the securities are segregated and individually registered on the relevant securities account, investors in a particular issue of securities held by an intermediary (e.g. a nominee) in a common pool have a co-proprietary interest in the pool".[120] However, the commingling and resulting co-ownership was styled as occurring *naturally* in cases where a number of security assets held by an investor cannot be allocated to a register-level *bloc* of security instruments. Where asset-holders' interests correlate directly with a separately registered set of security instruments, the holding of the asset-holder does not commingle, and the securities are not held collectively.

Yet even when securities are held collectively and the investors' interests have undergone a change from asset-holdership to co-asset-holdership in a fungible bulk, the system remains clearly *direct*. The kind of indirectness meant by Benjamin centres around whether there is, in the chain of holdership of securities, a depositary or similar intermediary who "stands in the chain of *ownership* between participants and issuers",[121] severing the proprietary nexus between holder and issuer, and enabling *only* rights against the nearest upstream intermediary holder.

As a good illustration, the author characterises CREST (a clearing and settlement provider for English securities) as a *direct* system, where "participants hold the underlying securities directly". This is instructive. Throughout Chapter 2 and 3, it was shown that the English securities system was highly influential on the South African dispensation, both in terms of law and institutional practice. This influence also appears to have had a major hand in the development of the South African uncertificated custody, clearing and settlement system.[122] As institutions in legal systems where *registered* securities enjoy primacy, it is unsurprising that CREST and Strate Ltd operate in a very similar manner. If Benjamin regards CREST as a "direct" system, it strongly suggests that Strate also operates, as a point of departure, directly. Is this a correct assumption?

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120 Vermaas (2010) *Acta Juridica* 91.

121 Benjamin *Interests in Securities* 26 [own emphasis].

122 See Chapter 2, § 2 2; and Chapter 3, § 3 2 1 2, § 3 2 2, and § 3 2 3.

Much work has been done in Chapter 4 and this chapter to reconcile the English legal influence – specifically the enabling English doctrine of constructive trust – on securities in South African law with the Civilian attributes of the jurisdiction's private law. From those outcomes, it is clear that asset-holdership of (or any limited real interest-holdership in) domestically issued securities constitutes *a legal interest in the security itself*, as a complex of rights and other competencies *between issuer and holder or holders.* The fact that the asset-holder's interests are only enforceable against the issuer via the instrument-holder does not render the former's interest an interest (specifically a proprietary interest) operating *solely* against the latter – it is clearly also operative against the issuer as performance-debtor.

Any further intermediation which may occur domestically does not alter this fact – intermediaries are merely agents or mandatories inserted between an asset-holder (and perhaps other limited real interest-holders), and an instrument-holder respectively.[123] Thus, where intermediated securities are domestically issued and held, the applicable legal principles dictate that the patrimonial elements of securities are "owned" (or rather held) *directly* by the end-of-chain investor. From this a strong argument arises for asserting that the domestic system of dematerialised (registered) securities holdership must in fact be wholly direct, as it does not place any intermediary in the chain of *ownership* between the issuer and the investor to the exclusion of all others. Put differently, separated asset- and instrument-holdership does not sever the proprietary nexus between investor and issuer.[124]

This observation turns the discussion back to a key doctrinal conflict between the manner in which South African law enables the existence of the registered security and the manner in which it is enabled in English law. English law does not have an absolute form of ownership or rights-holdership. Instead, it merely solves disputes of legal priority amongst specified parties. This, together with the (historically more personalised) nature of English obligations, had a profound influence on the development of the English law concept of the registered security.[125] Novation was required for transfer of early English securities, from which arose the securities register. The existence of the register then paved the way for the English law of trust to shape the modern

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123 With the intercedence of (1) a "fund" (i.e. a collective investment schemes or unregulated funds), or (2) a securitisation scheme, the interest held by the investor also remains direct, albeit for a different reason. Typically the shares issued under a CIS, or debt securities issued by a special purpose vehicle (through security- or asset-holdership) in a securitisation scheme bear no direct or indirect link to the so-called underlying assets. These underlying assets, if they take the form of securities, are in no way held or owned by the investor (there is no direct or indirect legal interest), and instead an investor's held securities have value derived from those underlying securities.

124 See also Meissner (2019) § 13 2 3 5 244-245 in this regard.

125 See Chapter 2, § 2 2 1.

concepts of registered ownership (a form of legal title) and beneficial ownership (a form of equitable ownership).

Prior to this work, the legal view of registered securities in South African law reads as a sort of begrudging acceptance of the irreversible but ultimately theoretically blunt reception of the construct. It can now be understood that the *Civilian* concept of the components of the creditor's interest facilitates that same splitting in South African law without the doctrinal conflict associated with the English concept of trust (see, generally, Chapter 4).

Yet these very divergent common law underpinnings of the registered security make the use of Benjamin's "interests in securities" concept very difficult in the domestic system.

In outlining the legal nature of interests in securities (as "*legally distinct*" from securities), Benjamin states that:[126]

> "[i]nterests in securities confer on their holders rights of property in relation to the underlying securities. However, they only do so indirectly, as against the intermediary in whose account the interests are recorded…the holder of an interest in securities does not have a direct claim against the issuer of the underlying securities. She has an economic interest in the underlying securities, but this must normally be enforced through the intermediary or intermediaries that stand between her and the issuer in the chain of ownership.
>
> [Under English law] intangible assets (such as interests in securities) are only subject to property rights *as against* intermediaries. Thus, where debt securities are held for an investor by a custodian, the rights of investor *as against the custodian* are proprietary, [in] the sense that they will not be at risk in the insolvency of the custodian. However, as against the issuer, any right in relation to the debt securities [is] personal, because of course the rights of investors are at risk in the insolvency of the issuer."

The principle that interests in securities confer *property rights exclusively against* the applicable securities-account administering intermediary is based on those deeper doctrinal principles of the English property law and constructive trust, in terms of which:[127]

> "an intangible asset may be the subject of a real action, but only as against a third party. For example, as against the debtor, the creditor can only assert personal rights in relation to the debt. However, if the debt is held through an intermediary, the creditor can assert real rights in relation to the debt, as against the intermediary. On this basis, *intermediation is not merely compatible with property rights in relation to intangibles; it is their precondition.*

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126 Benjamin *Interests in Securities* 39.

127 Benjamin *Interests in Securities* 305-306 [own emphasis in first paragraph only].

> Chapter 2 ["The Legal Nature of Interests in Securities"] considered the legal arrangements under which a client may enjoy property rights in relation to assets held by an intermediary. In English law…while property rights in *tangible* assets may be intermediated under a bailment, property rights in *intangible* assets may only be intermediated under a trust. Thus, the law of property rights in relation to intangibles is the law of trusts."

From this, the first important point is that the relationship of trust, constructive or otherwise, is what *facilitates* the existence of any property rights of the beneficiary (i.e. end-of-chain investor) as against the intermediary (i.e. constructive trustee). The second key point is the policy basis for this particular dispensation of the law of equity. The underlying policy position aims to protect the beneficiary of an obligation which is held "in title" by an intermediary (acting as a type of trustee). Where a registered holder of a security holds personal rights against the issuer, the proceeds of those rights (at risk due to the "bilateral priority disputes" principle of English property law) must be protected from the trustee's personal creditors in the event of insolvency. This protection is provided by enabling the beneficiary to assert *(equitable) property rights* against the trustee with respect to the security. This allows the beneficial owner of the security to establish absolute primacy among those creditors (though it must be mentioned that this does appear to be a relatively new English legal phenomenon).[128] On this basis, Benjamin argues that under English law:[129]

> "obligations can only be subject to property rights as against someone other than the obligor. Personal or proprietary status is not unchangeably inherent in the asset, but depends upon whom is suing. In other words, property is a function of particular actions, and not of particular assets.
>
> Because the *in personam/in rem* distinction applies to actions (and the rights that are extrapolated from actions) and not to assets, it follows that both tangible and intangible assets may be subjected to both personal and property rights. This might be represented diagrammatically [as follows:]

	Personal rights	*Property rights*
Tangible assets	e.g. an unsettled bargain for the purchase of bearer bonds	e.g. holding of bearer bonds
Intangible assets	e.g. registered securities (as against the issuer)	e.g. interests in securities (as against the intermediary)

> …"

Third is the point that a beneficial owner's interest against a registered owner, though styled as proprietary, remains (due to the operative principles of the law of equity) a claim that is personal in

[128] Benjamin *Interests in Securities* 310-311.

[129] Benjamin *Interests in Securities* 305-306 & n 13.

nature.[130] This also makes clear why, despite the fact that CREST's uncertificated clearing and settlement platform is considered a *direct* system,[131] it could still be argued that an end-of-chain investor should nonetheless be considered a holder of an "interest in securities". This legal analysis appears perfectly compelling in the English legal system, though no definitive pronouncement on that need be made here.

The broader point is that the concept of *indirectness*, once so understood, is simply not doctrinally compatible with Civilian South African private law as applied to uncertificated securities domestically issued and held. A central tenet of the international interests in securities concept is that these interests are "legally distinct" from securities – i.e. that the interests stand alone, though in economic equivalence to the securities themselves.

Thus custody, clearing and settlement under the South African dispensation is (similar to England's CREST) *direct* – no clearing or settlement platform, or custodial intermediary, stands in the chain of ownership between investor and issuer. For example, whilst Strate Ltd performs both the central securities depository *and* many clearing and settlement functions for the JSE, it is trite that it is not a depository in the true sense. It deals in *dematerialised* (registered) securities. In Chapter 1, it was argued that under the South African regime even bearer securities must be integrated into the system by a further secondary issue and thus function like registered securities once the "representative" dematerialised security is issued.[132] Therefore where any domestically issued and held security is dematerialised (rather than immobilised) it will function, from a legal standpoint, as a registered security and become subject to the outcomes as described in this and the preceding Chapter.

Chapter 4 has also shown that the patrimonial, or proprietary, element of securities resides within the security asset, and has economic value protectable *erga omnes*. This is a function of the Civilian, Gaian-influenced, and abstract South African property law. The principle is well illustrated by *Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd* in its intimation of the availability of the *quasi-rei vindicatio* to beneficial interest holders of securities.[133] The security asset has also been shown to confer no patrimonial interest on the instrument-holder and cannot be counted (specifically by would-be creditors) as an "asset" in the instrument-holder's estate.[134] This

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130 Benjamin *Interests in Securities* 306 & n 15 – "Equity acts *in personam*."

131 Benjamin *Interests in Securities* 26 – "In a direct system, participants hold the underlying securities directly. The settlement system does not stand in the chain of ownership, but merely serves as a conduit for communications of participants to issuers, CREST in the United Kingdom is an example of a direct system."

132 See § 1 1. See also the meaning of "deposit" above in § 5 1 1 1.

133 1976 (1) SA 441 (A). This notion is taken to its logical conclusion in Chapter 10 of this work, and the proposed availability of this essentially real action to the beneficial interest holder of shares further supports the absolute nature of asset-holdership.

134 See also Chapter 8, § 8 4.

removes the need to posit, as English law is forced to, a second equivalent interest which is protectable in equity as property against insolvency.

Seen thus, instead of a *unitary* underlying security and a number of separate but economically equivalent "downstream" proprietary legal interests, the South African security *itself is split* into a security and instrument. Various interceding intermediaries may perform administrative functions arising in the course of the *real* relationship between asset- and instrument-holder. Yet – crucially – none of these intermediaries hold any proprietary interest vis-à-vis their adjacent counterparts within the chain of intermediation.[135]

Critically, the presence of an instrument-holder also does not sever the proprietary nexus between issuer and asset-holder, and as such does not stand between the issuer and the asset-holder in the "chain of ownership". This is, first, because of the abstract nature of the South African property law – holdership of the incidents of execution (as derived from the entitlement of determination) of the underlying patrimonial interest does not, as it does in English law, arrest the proprietary nature of asset-holdership. Second and more importantly, it is because the "*in personam/in rem* distinction" in South African law rests not on remedies ("actions"), but on *rights*.

Somewhat ironically, this outcome does not have relevance to most Civilian custody, clearing and settlement systems. This is due to the overwhelming prevalence of immobilised (bearer or otherwise negotiable) securities in those systems. This is also true of the two key international clearing and settlement systems *Euroclear* or *Clearstream*,[136] as these platforms deal primarily with the immobilisation of *tangible* securities, mostly through the holding of a "global" instrument by a depositary. In such a system, it is wholly accurate to state that the depositary or one of its direct participants does indeed stand in the chain of *ownership* as the non-putative, actual bearer of the securities.[137] In that situation, the relationship between the custodian (i.e. depositary in the true sense, or a participant) and the end-of-chain investor is "indirect" in a sense where the interests in securities concept is very much legally applicable.

As an aside, this outcome highlights, perhaps more than any other element of this work, the particularly unusual and hybrid legal nature of the South African security as a product of its uniquely mixed legal system.

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135 See also Meissner (2019) 229-230 and 245-246.

136 See Chapter 2, § 2 2 1 (citing E Micheler "English and German securities law: a thesis in doctrinal path dependence" (2007) 123 *Law Quarterly Review* 251 262-264 & 272-276; HD Jencken "On some points of difference between the English system of law and that prevailing on the Continent regarding negotiable securities" *Journal of the Institute of Bankers* 1 (1880) 430; FR Malan *Collective Securities Depositories and the Transfer of Securities* (1984) 7-11); Chapter 3, § 3 2 1; as well as Benjamin *Interests in Securities* 23-24.

137 See Chapter 3, § 3 2 1 1, as well as Benjamin *Interests in Securities* 32 & 35..

In sum – securities which are issued and held in South Africa cannot be said to be indirectly held in a manner that points to legally separate and distinct interest in securities held by various intermediaries and the end-of-chain investor.

Finally, ignoring the seemingly definitive outcome of this indirectness analysis, there is the third question of whether South African securities are, or may be, "*unallocated*". This remains an important question, and it is this quality that prompts the use of the plural securities in the phrase "interests in securities". Securities are unallocated when the *settlement system* does not attribute specific securities to its *participants.*[138]

Here again it may be useful to outline the position in England under CREST.[139] As mentioned, CREST is a *direct* system – CREST members (i.e. participants) most typically hold and utilise a single pooled, or omnibus, account for their respective clients. In England, issuers' registers are still maintained in the dematerialised context (by issuers or an appointed registrar acting for issuers), and these are reconciled with the securities accounts maintained by CREST. Each issuer's register and the securities accounts of CREST reflect the details of the member, irrespective for whom the member is holding the securities. However, where the member holds securities in own name it must maintain a second account for segregation purposes, and the issuers' registers will reflect this. Further, members can (and do) offer to hold securities for clients on an individual basis and as such will hold further separate accounts in a similar fashion to holdership in own name (as the issuers' registers will also show). This is key, as it means that where a member operates an omnibus account its clients' securities are held as commingled, so that they hold *interests in* securities; conversely, where a member operates a separate account for a client, that client holds *securities* rather that interests in securities.

As a definitive answer to the allocation question in South African law, one must look to the boundaries of the custody and administration system in relation to its underlying end-of-chain investors. This is arrived at through the understanding of the duties of allocation (or segregation) of CSDs and CSDPs, and to a lesser extent non-register level account-maintaining nominees and authorised users – as covered by § 5 1 2 as well as the discussion of securities held collectively in § 5 1 3. This work demonstrates that securities accounts throughout the custody and administration system must contain details of the instrument-holders (i.e. those persons on the uncertificated securities register maintained by a CSD and CSDPs) and the details of the clients for whom they are kept. *Within* that system, instrument-holdership is known and end-of-chain asset-holdership may or may not be known, depending on the level of intermediation.

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138 Benjamin *Interests in Securities* 28.

139 See Benjamin *Interests in Securities* 204 & 207 for what follows.

Yet, even in cases where full end-of-chain asset-holdership is not traceable within the system of accounts, one could not answer the allocation question in the negative. The interests in securities concept requires that the “interests of all participants holding the relevant (interests in) securities are held together by the settlement system in a commingled pool…record[ing] how many (interests in securities) are held by each participant, but not which ones.”[140]

It has been shown in § 5 1 2 above that a securities account will always reflect a specific *client* and *instrument-holder* – i.e. the next intermediary or the asset-holder (as the case may be), and holder of the incidents of execution of a particular security’s underlying rights and other competencies, respectively.

The clearing and settlement system must process (netted or individualised, depending on the system) securities account debits and credits. Yet the account entries themselves must, according to s 51(5) of the Companies Act as incorporated by s 39 of the FMA, contain inter alia both the name of transferee (i.e. instrument-holder) and a “description of the securities or interest transferred”.

Chapter 4’s reconceptualisation of the nature of securities as legally dichotomous shows that there will always be an innate subjective rights-level nexus between the instrument-holder and asset-holder of a security. It also shows that this nexus flows from the proprietary characteristics that arise as a consequence from that dichotomy (most obvious in the fiduciary dimension of that relationship of representation). This, when seen in light of the information that is required to accompany a securities account entry within a particular securities account, should be seen as decisive, despite the commingling of the security *assets* demarcated by those instruments.

Quite simply, where a security instrument is allocated, the security is allocated, regardless of the existence within a register-level account of a commingled pool of security assets to which (co-) asset-holders have merely equivalent proprietary claims instead of a claim to a specific security asset or number of assets. In the past it may not have been apparent how deeply connected a nominee is to the underlying substance of a particular security, as it was often seen as a mere agency-based arrangement. This may have enabled the idea that the *securities themselves* were pooled, so that even where securities were allocated to specific nominees, allocation could yield no legal information regarding beneficial ownership. Yet there is a stronger argument that a *component* of *each* of the securities themselves (namely, instrument-holdership) is indeed already allocated, notwithstanding that the other component (the security asset) may or may not be allocated to a *bloc* of security instruments at register-level.

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140 Benjamin *Interests in Securities* 28.

This should make it clear that domestically held and issued uncertificated securities are in all probability not "unallocated".

Thus, to summarise the comparative analysis, South African asset-holdership lacks two of the three core qualities of interests in securities – non-allocation and indirectness. Therefore, one does not have to go any further to conclude that the international interests in securities concept cannot be applied to domestically issued and held securities which have been dematerialised. To do so would be, at least, doctrinally unsound. However, where local bearer securities have been immobilised, rather than dematerialised, the concept could perhaps still find application.

This brings one to the second part of the analysis of this section – the concept's applicability to securities which are held or traded across borders. This particular topic is so vast and complex that it deserves its own work altogether, and a very limited analysis of this topic must suffice here.

Where securities are traded across borders, the drive for uniformity, compatibility and stability has led to two main models which may facilitate such transactions. The first is the "hub and spoke" method, where an international securities settlement system (of which the two primary systems are Euroclear in Belgium, and Clearstream in Luxembourg) provides clearing and settlement as hub to national settlement systems who stand in the role of participant as spokes. The second is the "spider's web", through which national clearing and settlement systems establish mutual links with one another, one or both acting as participant in the system of the other.[141]

These two models, or methods, need to be understood in terms of the manner in which the domestic dispensation (under the FMA, Companies Act, and common law by registered securities and dematerialisation) would account for such arrangements. This means accounting for the *direct* nature of the settlement system of the FMA. Where settlement systems operate indirectly:[142]

> "the operator of the settlement system and/or its depositary stand in the chain of ownership between the issuer of the underlying securities and participants. In such cases, the customary method of forming cross-border links between two systems is very simple: a sub-custodian of the operator or depositary of the first system becomes a participant in the second system."

Direct systems pose more of a challenge. Here a brief extension of the comparative analysis of the English system under CREST is beneficial in accounting for the dynamics of forming of cross-border links between domestic CSDs and foreign securities and settlement systems. The key to

141 Benjamin *Interests in Securities* 201.

142 See Benjamin *Interests in Securities* 218-219.

understanding how this is achieved in a direct custody, clearing and settlement system is the use of *depositary receipts* (listed in the FMA as securities – see s 1 *viz.* “securities”).

Under CREST, only the securities of the United Kingdom may be settled on the system. In order to facilitate transactions with regard to foreign securities, CREST established two special purpose entities – a nominee entity, and a depositary entity. This configuration exists in order to *interpose CREST into the chain of “ownership”* of these securities, thereby overcoming the central problem of cross-border intermediation where a system of direct holdership must integrate into a system predicated on interests in securities.

In order to achieve this, two steps are necessary. First, the nominee company becomes a participant to the foreign settlement operator (e.g. Monte Titoli in Italy) and acquires ownership of the security in terms of the laws and rules of that foreign jurisdiction. Crucially, it does so as *nominee for the second, depositary, entity of CREST.*

The second step is that the depositary company, now the beneficial owner of the foreign security, *issues a new security* – a depositary receipt (called a CREST Depositary Interest, or CDI) in favour of the client. The CDI is issued as the economic equivalent of the foreign security, so that the CREST client (and by implication end-of-chain investor) may conclude the transaction in question as if dealing in the foreign security itself.[143]

In this light, in order to facilitate transactions with regard to securities issued in other jurisdictions, South African CSDs – as direct settlement systems – use broadly the same method. A good example is the JSE’s “South African Depositary Receipts” (or SADRs).[144]

However, the above deals only with the equity market. Listed debt securities are typically issued in lower volume but at higher value, mainly to institutional investors. This suggests that cross-border debt securities transactions could also, as an alternative to depository receipts, be facilitated through investment and commercial banks in more bespoke arrangements, and in all likelihood using global custodian arrangements rather than depositary receipts issued by a domestic CSD.

Here one example of a hybrid of the depositary receipt and custodial models stands out – Rand Merchant Bank currently offers “US Dollar Custodial Certificates” on the exchange traded funds platform of the JSE. The scheme is structured as an exchange traded fund (“ETF”), whereby RMB (as opposed to the CSD) operates as a participant in the foreign market. RMB purchases and holds

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143 See Benjamin *Interests in Securities* 203 & 219.

144 See for instance in JSE “South African Depositary Receipts” <https://www.jse.co.za/trade/equity-market/equities/depository-receipts> (accessed 31-01-2021).

the US treasuries, and in turn issues securities (the USDCSs) on the JSE's ETF market. The scheme is described as follows:[145]

> "RMB offers clients South Africa's first US Treasury bond custodial certificates. This investment, listed on the JSE in the ETF sector, is suitable for businesses and private individuals. Think of it as an online safety deposit box for US Treasury bonds. Clients can invest their excess cash in US dollars, earn an income stream in US dollars and benefit from a weakening rand all via the JSE.
>
> Our clients' investment capital credit exposure is directly linked to the US Treasury Department — therefore, they can avoid the credit risk associated with a normal foreign currency bank account. Businesses and individuals may invest without SARB exchange control restrictions, enabling excess cash to be invested in a highly liquid USD asset. The DCCs are liquid and freely traded, making them an ideal working capital solution. Clients' investment performance is directly related to the USD/ZAR exchange rate and the price performance of US Treasury bonds."

More broadly, the analysis here clarifies the *nature* of foreign securities as held through a depositary receipt system in the direct domestic clearing and settlement (and indeed *holdership*) environment. It would appear that depositary receipts are issued by an enabling special purpose vehicle of the facilitator of the scheme (e.g. an SPV of Strate Ltd or RMB), which then issued depositary receipts *as securities in own right*. This would make the conclusions of Chapter 4, as well as those of this chapter, equally applicable to these types of securities. The crucial implication is that an asset-holder with respect to a depositary receipt holds a patrimonial interest with respect to the issuer of that security, irrespective of the instrument-holder. That secondary securities' underlying value derives from the value of the securities held by the depositary receipt *issuer* (the special purpose vehicle). As regards the foreign security itself, it is fully accurate to state that a holder of a depositary receipt may have an interest in securities in the manner meant by Benjamin.

Attention can now be turned to the converse – foreign functionaries conducting transactions with respect to South African securities. Provision for such activities is evident also in a number of provisions, including some relatively new additions to the Financial Sector Regulation Act, No. 9 of 2017, in section 1 of the FMA:

> "**'external authorised user'** means a foreign person who is authorised by a supervisory authority to perform a service or services similar to one or more securities services as defined in this Act and who is subject to the laws of a country other than the Republic, which laws—
>
> (a) establish a regulatory framework equivalent to that established by this Act; and

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145 Rand Merchant Bank "Dollar Custodial Certificates" <https://www.rmb.co.za/page/dollar-custodial-certificate> (accessed 31-01-2021).

(b) are supervised by a supervisory authority;

'external central counterparty' means a foreign person who is authorised by a supervisory authority to perform a function or functions similar to one or more of the functions of a central counterparty as set out in this Act and who is subject to the laws of a country other than the Republic, which laws—

(a) establish a regulatory framework equivalent to that established by this Act; and
(b) are supervised by a supervisory authority;

'external central securities depository' means a foreign person who is authorised by a supervisory authority to perform a function or functions similar to one or more of the functions of a central securities depository as set out in this Act and who is subject to the laws of a country other than the Republic, which laws—

(a) establish a regulatory framework equivalent to that established by this Act; and
(b) are supervised by a supervisory authority;

'external exchange' means a foreign person who is authorised by a supervisory authority to perform a function or functions similar to one or more of the functions of an exchange as set out in this Act and who is subject to the laws of a country other than the Republic, which laws—

(a) establish a regulatory framework equivalent to that established by this Act; and
(b) are supervised by a supervisory authority;

'external market infrastructure' means each of the following:

(a) An external central counterparty;
(b) an external central securities depository;
(c) an external clearing house;
(d) an external exchange;
(e) an external trade repository;

'external participant' means a foreign person who is authorised by a supervisory authority to perform a service or services similar to one or more of the services of a participant or an external central securities depository as set out in this Act, and who is subject to the laws of a country other than the Republic, which laws—

(a) establish a regulatory framework equivalent to that established by this Act; and
(b) are supervised by a supervisory authority;

…

'securities' means—

(a) listed and unlisted—

(i) shares, depository receipts and other equivalent equities in public companies, other than shares in a share block company as defined in the Share Blocks Control Act, 1980 (Act No. 59 of 1980);

…

(v) participatory interests in a collective investment scheme as defined in the Collective Investment Schemes Control Act, 2002 (Act No. 45 of 2002), and units or any other form of participation in a foreign collective investment scheme approved by the Authority in terms of section 65 of that Act;

(b) units or any other form of participation in a collective investment scheme licensed or registered in a country other than the Republic;

(c) the securities contemplated in paragraphs (a) (i) to (vi) and (b) that are listed on an external exchange…"

All the "external" functionaries defined above are also included in their corresponding domestic definitions in s 1, so that for example the definitions of "participant" or "central securities depositary" include external participants or external central securities depositories, respectively. These provisions enable foreign participation in South African securities markets – for example Euroclear opened a Segregated Depositary Account with Strate Ltd for this purpose in 2012.[146] These actors then operate in the domestic marketplace in the exact same way as the local actors do.

Finally, this analysis also allows one to better understand the phrase "an interest in a security" in the FMA and Companies Act, as well as whether it is meant to refer (always, or contextually) to the similar phrase which has thus-far served as the subject of this section.

Uncertainty in this regard stems chiefly from s 38(1) of FMA which, with emphasis added, references the term as follows:

> "[t]he transfer of…an *interest in uncertificated securities* on the uncertificated securities register held by a central securities depository or participant must be effected in the manner provided for in Chapter 2, Part E of the Companies Act, where applicable, and the depository rules, *by making the debit and credit entries respectively* in the central securities account or securities account of the transferor and the transferee kept by the central securities depository or the participant."

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146 Strate Ltd "Euroclear opens a Segregated Depository Account at Strate" (27-12-2012) *Strate Blog* <http://www.strate.co.za/blog/2012/12/euroclear-opens-a-segregated-depository-account-at-strate/> (accessed 21-04-2018).

Further muddying the issue is the content of s 36(2)(a)(ii) of the FMA, which reads:

> "(2)(a) No central securities depository or participant may become the owner, co-owner, holder, pledgee or cessionary for the purpose of securing a debt, of securities merely because of—
>
> …
>
> (ii) the registration in its name of—
>
> (aa) securities;
>
> (bb) limited rights in securities;
>
> (cc) other rights in securities;
>
> (dd) benefits in respect of securities; or
>
> (ee) benefits accruing to securities."

It is very difficult to determine what is being anticipated by these provisions other than simply clarifying the distinction between the custodial and administrative functions that CSDs and CSDPs may fulfil (as per § 5 1 2 above), and doing so in the (unnecessarily) broadest possible way.

Ultimately, in the context of domestic securities transactions relating to foreign securities, it is difficult to so see how the FMA's mention of interests in uncertificated securities or the limited interests described in s 36(2), could find application in a *direct* system of clearing, settlement and holdership. Where a domestic CSD or exchange is involved, the issuing of secondary, equivalent securities seems to be the only manner in which to enable this kind of activity.

This implies that whilst the holder of depositary receipt may indeed have an "interest in securities" as meant by Benjamin, what is in fact *held and dealt with domestically* by its holder or holders is a second, representative uncertificated security outright. In terms of the converse, the only manner in which to hold and deal with listed or uncertificated domestic securities abroad appears to be the reversed method of becoming a participant to the domestic CSD, as Euroclear has done via its opening of an SDA at Strate. In such cases, it may well be that foreign holders hold interests in securities, but that does not change any element of the domestic legal position.

It would appear, in conclusion, that: (1) "interests in uncertificated securities" as used in the FMA must refer to a domestic construct that is different from the meaning of the similar phrase as used by Benjamin; and (2) the phrase is of little to no statutory usefulness domestically. As suggested in *Commentary 2008*, "the general impression is that in a number of instances it references uncertificated securities interchangeably with 'interests in uncertificated securities' or specifies both out of an abundance of caution, rather than as a result of technical exactitude."[147]

It is, however, submitted that this phrase has an important meaning in the particularly applicable principles of South African *common law* as preliminarily outlined in § 4 3 2 2 of Chapter 4 when dealing with individualised incidents serving as the object of limited real rights. Specifically, as a point of departure, the term "interests in uncertificated securities" should, and must, serve to indicate those limited real rights – i.e. *limited real interests in securities.* This is dealt with briefly in the final section of Chapter 8.

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[147] Yeats et al *Commentary 2008* 2-614.

CHAPTER 6

6 The classification of securities

This chapter, as the final part of the analytic-systemic approach within this work, deals mainly with the problem of identifying, and through identification ascribing meaning to, the "securities concept" within the broader realm of financial instruments. In order to systematise the concepts necessary for a truly analytic-systemic approach, what is meant by "securities" must be identifiable, in order to distinguish these phenomena from other financial instruments.

The ability to identify and distinguish in this way is ultimately a function of the ability to make an appropriate and accurate *legal classification.* Classification, in turn, is a crucial prerequisite for an appropriate application of the law, on which rests a proficient functioning of debt securities in South African law.

In § 4 2 of Chapter 4, three hypothetical scenarios were used to illustrate the potential consequences of this classificatory problem within the South African securities law.[1] This chapter is primarily devoted to this problem, using the broader continuum of "financial instruments" as its initial frame of reference. Thus, first, it broadly establishes the boundaries of the financial instrument concept, and thereafter outlines the merits of a typological solution to classifying (and thereby identifying) securities within that continuum. This also facilitates an understanding of the *substantive* elements of the concept, in contrast to the formal and enumerative definitions found in the domestic legislative environment.

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[1] See Chapter 4, § 4 2.

Chapters 4 and 5 provided a theoretical framework to rationalise the deeper principles of law and inform its treatment of (debt) securities. Yet, all of the chapters' outcomes are applicable to securities. As this chapter aims to show, this is a far more difficult question than it appears and none of the extant legal issues can be dealt with in Part 2 unless the boundaries of the securities concept are clarified.

6 1 The taxonomical contours of financial instruments and securities

This section sets out a taxonomical topography of financial instruments, with particular emphasis on what can be learned from legislation. It shows that securities are part of the broader *genus* of financial instruments. It further posits that the term "instrument" itself, when found in the financial legal context, should be construed as widely as possible (and is not to be conflated with the traditional, stricter legal definition as "the physical embodiment of a payment obligation").[2] It is further vital to distinguish security instrument (the technical phrase arrived at in Chapter 4 referring to one of the two components of every registered security) from "instrument" as it is used in this chapter.

It also aims to demonstrate that the law's current approach to securities is broad, contextually variable, and lacking in depth and substance. Specifically, any current statutory definition of "securities" is invariably merely an enumerative list, citing (often legally *even less* well defined) financial instruments which are then to be considered securities. This aptly illustrates the classificatory problem faced by South African securities law.[3]

First, one must understand financial instruments as a category, or *genus*. The term "instrument" is central to financial legislation and is also often used in the context of securities. This can be illustrated (with emphasis on the myriad uses of instrument) as follows.

In s 1 of the Companies Act[4] "securities" are defined as:

> "any shares, debentures or other *instruments*, irrespective of their form or title, issued or authorised to be issued by a profit company"

Thereafter, in s 43 ("Securities other than shares"), the following is found:

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2 See R Goode *Commercial Law* 3 ed (2004) 476-477.

3 Note, however, that none of the specifically problematic aspects of these definitions will be dealt with below, as this is not the primary focus of this work.

4 71 of 2008.

"(1) In this section -

(vii) "debt *instrument*" -

(i) includes any securities other than the shares of a company, irrespective of whether or not issued in terms of a security document, such as a trust deed; but

(ii) does not include promissory notes and loans, whether constituting an encumbrance on the assets of the company or not; and

(i) "security document" includes any document by which a debt *instrument* is offered or proposed to be offered, embodying the terms and conditions of the debt *instrument* including, but not limited to, a trust deed or certificate."

In the context of s 43, the following comments are particularly instructive:[5]

"Often it is difficult to identify clear dividing lines between concepts such as debentures, bonds, notes, derivatives, bills of exchange, futures contracts, warrants, options and money market instruments. Accordingly, *it is suggested that the use of the term 'instruments' needs to be considered carefully in its context* and with reference to the ordinary meaning of securities issued by a company, commercial practice and possibly the intention of the company.

What is clear is that the instrument must be issued by a profit company. Generally, it would not include a bilateral contract, but instruments sometimes refer to and incorporate the terms of a contract and it is possible for a company to issue one instrument to one holder. While instruments would include certain 'derivative instruments' as defined in s 1 of the FMA, most 'derivative instruments' are unlikely to have been issued by a profit company. For example, while many futures contracts relate to the underlying securities issued by a profit company, they will not usually themselves be issued as a security by a profit company, though this may depend on the particular circumstances, the contracting parties, and the nature of the contract."

Furthermore the Financial Markets Act, although it does not define the term "financial instrument" itself, exhaustively defines all financial instruments which are to be regulated by it. In s 1 of the Financial Markets Act ("FMA"),[6] the term "instrument" also occurs multiple times:

"**'certificated securities'** means securities evidenced—

(*a*) in relation to securities issued by an issuer other than a public company, by a certificate or written *instrument*; or

5 JL Yeats, R de la Harpe, R Jooste, H Stoop, R Cassim, J Seligmann, L Kent, R Bradstreet, RC Williams, MF Cassim, E Swanepoel, FHI Cassim & K Jarvis (2018) *Commentary on the Companies Act of 2008* Int-98.

6 19 of 2012.

(*b*) in relation to securities issued by a public company, by a certificate;

…

'derivative *instrument*' means any—

(*a*) financial *instrument*; or

(*b*) contract,

that creates rights and obligations and whose value depends on or is derived from the value of one or more underlying asset, rate or index, on a measure of economic value or on a default event;

…

'money market securities' means money market *instruments* that are uncertificated securities reflected in an uncertificated securities register;

…

'securities' means—

(e) listed and unlisted-

(i) shares, depository receipts and other equivalent equities in public companies, other than shares in a share block company as defined in the Share Blocks Control Act, 1980 (Act 59 of 1980);

(ii) debentures, and bonds issued by public companies, public state-owned enterprises, the South African Reserve Bank and the Government of the Republic of South Africa;

(iii) derivative *instruments*;

(iv) notes;

(v) participatory interests in a collective investment scheme as defined in the Collective Investment Schemes Control Act, 2002 (Act 45 of 2002), and units or any other form of participation in a foreign collective investment scheme approved by the Registrar of Collective Investment Schemes in terms of section 65 of that Act; and

(vi) *instruments* based on an index;

(b) units or any other form of participation in a collective investment scheme licensed or registered in a country other than the Republic;

(c) the securities contemplated in paragraphs (a) (i) to (vi) and (b) that are listed on an external exchange;

(d) an *instrument* similar to one or more of the securities contemplated in paragraphs (a) to (c) prescribed by the registrar to be a security for the purposes of this Act;

(e) rights in the securities referred to in paragraphs (a) to (d), but excludes

(i) money market securities, except for the purposes of Chapter IV; or if prescribed by the registrar as contemplated in paragraph (d);

(ii) the share capital of the South African Reserve Bank referred to in section 21 of the South African Reserve Bank Act, 1989 (Act 90 of 1989); and

(iii) any security contemplated in paragraph (a) prescribed by the registrar…"

In all of the above cases the term "instrument" remains undefined or otherwise delineated.

Nonetheless, in the present context it would not be contentious to state that the legislature (and indeed more broadly the law and commercial practice in this context) is concerned with *financial* instruments.[7] This more specific term, on the other hand, has been given a multitude of definitions or descriptions in many fields.

In the thirty-second International Accounting Standard ("IAS 32" – "Financial Instruments") a financial instrument is defined as "a contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity". A "financial asset" includes cash, the equity instruments of other entities, contractual rights, or contracts that can be settled with the applicable entity's own equity instruments (subject to certain requirements).[8] What is quite problematic from a legal standpoint is that an "equity instrument" is understood by IAS 32 as "[a]ny *contract* that evidences a residual interest in the assets of an entity after deducting all of its liabilities." In South African law, it is trite that a share is not strictly a contract,[9] which for legal purposes implies that financial instruments are not limited to instruments of a purely contractual nature.

In a wider commercial sense, a financial instrument has been defined as:[10]

> "[a] real or virtual document representing a legal agreement involving some sort of monetary value. In today's financial marketplace, financial instruments can be classified generally as equity based,

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7 The phrase also occurs only twice in the Companies Act 61 of 1973, and only when defining a security (the term "instrument" occurs multiple times elsewhere, but only in reference to the Memorandum, or an "instrument of transfer" for the transfer of securities).

First is s 130A, in which a security is defined as: "any listed security as defined in section 1 of the Stock Exchanges Control Act, 1985; and (b) any financial instrument which confers the right to convert such instrument into a listed security referred to in paragraph (a)".

Second is s 440A, where a security is defined as "any shares in the capital of a company and includes stock and debentures convertible into shares and any rights or interests in a company or in respect of any such shares, stock or debentures, and includes any "financial instrument" as defined in the Financial Markets Control Act, 1989 (Act 55 of 1989)".

8 IAS 32.11.

9 See Chapter 4, specifically § 4 2.

10 Investopedia "Financial Instrument" <http://www.investopedia.com/terms/f/financialinstrument.asp?optm=sa_v2> (accessed 15-11-2016).

representing ownership of the asset, or debt based, representing a loan made by an investor to the owner of the asset. Foreign exchange instruments comprise a third, unique type of instrument. Different subcategories of each instrument type exist, such as preferred share equity and common share equity, for example…"

or as:[11]

"[a] document (such as a [cheque], draft, bond, share, bill of exchange, futures or options contract) that has monetary value or represents a legally enforceable (binding) agreement between two or more parties regarding a right to payment of money…"

Finally there are also two statutory definitions that further make the boundaries of the concept clearer. The (repealed) Financial Markets Control Act of 1989, in s 1, provided that "financial instrument":

"means

(*a*) a futures contract;

(*b*) an option contract;

(*c*) loan stock; or

(*d*) any other instrument declared by the Registrar by notice in the *Government Gazette* to be a financial instrument…"

This definition is significant. This act was legislated in part to allow the establishment of exchanges other than those contemplated in the Stock Exchanges Control Act.[12] The definition above is clearly limited, excluding, for instance, equity instruments unless so designated by the Minister in terms of ss (d). This definition, but for its contextual purpose, would appear to have been drafted too narrowly. However, it served an express and definite purpose – to allow the establishment of exchanges dealing in financial instruments *other than equities*, which were already accounted for in another act.

The only conclusion that can be drawn from this is that there is a need for *teleological flexibility* in the identification of financial instruments (and more importantly of *securities* within that broader category). This demonstrates that any identification methodology must account for the specific act,

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11 Business Dictionary – "What is a Financial Instrument?" <http://www.businessdictionary.com/definition/financial-instrument.html> (accessed 04-03-2017).

12 See Chapter 2, § 2 3 2.

or other legal rule, for which such identification is required. This point is simple yet fundamental, and it informs much of what is stated in the following section.

Finally, in s 1 of the Income Tax Act,[13] the term receives its most detailed treatment. It reads as follows:

> "**'financial instrument'** includes—
>
> (*a*) a loan, advance, debt, bond, debenture, bill, share, promissory note, banker's acceptance, negotiable certificate of deposit, deposit with a financial institution, a participatory interest in a portfolio of a collective investment scheme, or a similar instrument;
>
> (*b*) any repurchase or resale agreement, forward purchase arrangement, forward sale arrangement, futures contract, option contract or swap contract;
>
> (*c*) any other contractual right or obligation the value of which is determined directly or indirectly with reference to—
>
> (i) a debt security or equity;
>
> (ii) any commodity as quoted on an exchange; or
>
> (iii) a rate index or a specified index;
>
> (*d*) any interest-bearing arrangement; and
>
> (*e*) any financial arrangement based on or determined with reference to the time value of money or cash flow or the exchange or transfer of an asset…"

The scheme of this particular act, contrastingly, requires a far broader meaning to be given to the term, and it is achieved by widening the enumerative scope of instruments designated as financial instruments.

From this, three points emerge. First is the observation that, taxonomically, "financial instruments" include securities, but the term represents a far broader *genus* of financial assets. Clearly not all financial instruments are securities, but it is uncontentious to assert that all securities are financial instruments. Securities are a type of financial instrument, but one type among many. This broader *genus* includes equities, debt securities, other specific contracts and sub-types of such contracts (such as the various swaps, options, futures, and other derivative instruments), negotiable

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[13] 58 of 1962.

instruments (where the term instrument has a specific, technical legal meaning),[14] money market instruments (and securities), and potentially other instruments or "arrangements". Further, financial instruments should not be seen as a *numerus clausus*.

Second, it is clear that when the phrase is defined (or rather enumerated) in legislation, it is done *to give effect to the purpose of the particular statute in question.* Each of the above acts shares the same core conception of a financial instrument but describes it in different terms and with a wider or narrower scope, depending on the legislative purpose of the definition, description, or enumeration. Therefore, when attempting to substantively (and therefore more abstractly) delineate the securities concept, there is a teleological imperative that must be accounted for in the analysis.

Third, it also appears as though, *in this context*, the word "instrument" has no fixed, technical juridical meaning. In fact, its ordinary plain language meaning has the most utility, as "a means whereby something is achieved, performed, or furthered".[15] At face value this may not feel intuitively correct, as the term instrument does indeed have a number of technical legal meanings. Yet in this financial context a plain language understanding does more for the analysis. In coming to grips with the meaning behind instrument in the expression "financial instrument", an ordinary meaning appears far more useful and robust than a variation of the "documentary" definition usually encountered.[16]

In light of the above, the central question is how to determine whether a particular financial instrument can – and, crucially, when it *should* – be classified, irrespective of name or form, as a security, or not.

6 2 Typologically differentiating securities from other financial instruments

Classification is the key to the identification and differentiation of legal phenomena, and therefore is the focus of this chapter.

Specifically, this chapter is concerned with determining whether (and, teleologically, when) a financial phenomenon is a "security" or whether it should be classified as something different within – or even wholly outside of – the broader *genus* of financial instruments. The answer to this question, in turn, points to whether, for example, a borrowing contract falls within or without the scope of s 43

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14 See DV Cowen & L Gering *The Law of Negotiable Instruments in South Africa: Volume 1* (1985) 6, 23, 24, 31 & 84.

15 Merriam Webster – "instrument" <http://www.merriam-webster.com/dictionary/instrument> (accessed 24-03-2016).

16 A definitional approach which is, quite obviously, not fit for an analysis of the securities environment.

of the Companies Act. As illustration, Delport et al make the following point regarding the definition of debt instrument in s 43 of the Companies Act.[17]

> "This definition creates uncertainty as it is not clear whether a debenture can be *classified* as a debt instrument as the basis of the debenture is actually a loan...A debenture is, as defined in the common law, therefore basically 'an acknowledgement of debt in favour of the holder as a creditor of the company for the specified amount with a right to interest therein stipulated…'. Therefore the definition of debt instrument includes a debenture (by incorporating 'securities' as defined in s 1), but then again excludes debentures by implication due to the exclusion of loans."

This interpretation makes little sense, mainly because it does not accord with the manner in which the debenture and debt security concepts have developed in modern South African law, as outlined in Chapters 3 and 4. In that light, first it must be questioned whether the term "debenture" in the present state of the law is still merely a reference to a specific type of documentary instrument augmenting an underlying loan, or a more holistic reference to the security itself, as comprising the security asset and instrument.[18] The answer is undoubtedly the latter. Second, and irrespective of the view taken on the first question, is the deeper classificatory question of whether a loan, when serving as one of the components of the architecture of a more complex financial instrument (such as a debt security), is still classifiable as a "loan", or whether such an instrument – with a built-in loan – is *something entirely different*. This problem is typical of many acts, and individual rules, that deal with some aspect of "securities".

Therefore, this section sets out the merits of a *typological* methodology. It is argued that a typological approach is able to classify financial instruments as securities accurately and appropriately, despite the challenging variability in form and function evidenced by the broader spectrum of modern securities and other instruments. Typological classification is founded on the theory of types, or *Typenlehre*. The first part of this section is a brief outline of its theoretical foundations and place in South African law. Its broader philosophical roots are beyond the scope of this work. The second part deals with its application to the classification of financial instruments as securities.

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17 PA Delport *New Entrepreneurial Law* (2014) 63 [own emphasis]. See also PA Delport et al *Henochsberg on the Companies Act 71 of 2008* (SI 11 – 2015) § 43 184-184(3) for further, similar, interpretive issues.

18 See Chapter 3, § 3 1 1 1 and § 3 1 1 2; as well as § 3 1 3 2 generally for the beginnings of shift towards a more holistic conceptualisation.

6 2 1 The Typenlehre

Classifying any legal phenomenon implies both the ability to identify *and* distinguish it from phenomena which are "similar but not same". This is not a new legal problem and has arisen in other contexts. The problem has appeared when attempting to distinguish real and personal subjective rights from one another.[19] It is also relevant when determining the particular set of naturally implied terms, or *naturalia* (in the wider sense),[20] that should be applied to a contract – this is determined by which type (or sub-type) of contract is being dealt with, requiring a classificatory determination.[21] Another (and perhaps the most notable) instance is where a particular service engagement must be classified as a *locatio conductio operarum* or *operis*.[22] The issue has also arisen in determining what is, and is not, a "financial lease".[23]

The above-mentioned instances of classificatory difficulty were chosen for a specific purpose – the potential application of the *Typenlehre*. The first three examples appear in a work by T Naudé,[24] discussing in detail, and very astutely, the usefulness of applying the *Typenlehre* ("theory of types", or typological) methodology of legal classification to South African contract law as a supplementary means by which ambiguous contract types can be classified. The last example is the subject of N Joubert's contribution on the legal nature of the financial lease and is an instance of where the *Typenlehre* methodology is considered but ultimately rejected.[25]

Naudé's work presents a convincing case for the methodology itself and shows clearly when it would be appropriate to apply it in a South African law context. Briefly, Naudé's treatment of this theory, which is of German origin, can be summarised as follows. Certain contracts, due to the inherent

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19 CG Van der Merwe *Sakereg* (1979) 46; or CG Van der Merwe *Sakereg* 2 ed (1989) 63.

20 "Legal incidents is a useful phrase denoting a wider meaning including all residual rules, *ex lege* terms, and variable sets of rules that automatically attach to specific types of contracts, and is preferable here to '*naturalia*'…" – T Naudé "The preconditions for recognition of a specific type or sub-type of contract – the *essentialia-naturalia* approach and the typological method" (2003) *Tydskrif vir die Suid-Afrikaanse Reg* 411 413. See also therein n 14 & 16 – citing JP Vorster *Implied Terms in the law of England and South Africa* LLD thesis Cambridge (1987); and M Vorster "The resolution of contractual disputes: interpretation *versus* the recognition of novel *naturalia*" (1987) 50 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 450 to the same effect.

Naturally the term "incidents" has been used in the previous two chapters to denote something different, and so the term *naturalia* will suffice for present purposes.

21 The subject of Naudé (2003) *TSAR* 411, which is discussed at length below; see as well N Joubert "Die regsaard van die finansiële huurkontrak" (1989) *Tydskrif vir die Suid-Afrikaanse Reg* 568.

22 *Minister van Polisie v Gamble* 1979 (4) SA 759 (A) 765; and *Mtetwa v Minister of Health* 1989 (3) SA 600 (D) 606.

23 Joubert (1989) *TSAR* 568.

24 The analysis of this section relies heavily on the treatment of the classical form of the *Typenlehre* by Prof Naudé in the South African context, but the original German exposition on this topic is best found in K Larenz *Methodenlehre der Rechtswissenschaft* (1975); D Leenen *Typus und Rechtsfindung* (1971); K Larenz & CW Canaris *Methodenlehre der Rechtswissenschaft* (1995); and L Kuhlen *Typuskonzeption in der Rechtstheorie* (1977).

25 Whether Joubert is correct in rejecting the methodology need not be debated here, as the focus is not on the typological approach in contract law.

flexibility of the South African law of contract,[26] are not easily classifiable using the traditional *essentialia-naturalia* model. In certain hard cases, classification via this model leads to the application of an inappropriate policy-mix of legal norms through the consequent (mis)construction of such contracts' *naturalia* and other residual rules. In remedying this, Naudé argues that the adoption of a typological approach to refine and improve classificatory outcomes has much supplementary value.[27]

First, it is vital to note that Naudé establishes convincingly that the typological method has found some application already in South African law. The most notable instance of its influence is in distinguishing *locatio conductio operarum* from *operis*.[28] Second, a strong case is made for the proposition that:[29]

> "where the *classificatory rules that prepare the way for the application of default rules* cannot be formulated as *essentialia,* this should not deter the recognition of a new (sub)type of contract formulated in terms of vaguer classificatory characteristics *where this is required to give effect to legitimate and real economic goals*. Whether one calls the resultant concept a 'type' or an 'open-ended concept' is not the important issue. If this is the only option, a continual attempt must be made to clarify the indicative features of the type as much as possible in the interest of legal certainty."

This rings true not only for classifying contract types, but other legal phenomena which exhibit (1) a tendency towards variability in form and substance, but (2) must, regardless, be grouped together for reasons of legal policy in the application of the law.

The two *locatio* contracts are distinguished typologically, and there is (limited) support for the idea that real and personal subjective rights could perhaps also be distinguished on this basis.[30] What is proposed here is that the *Typenlehre* is the most effective methodology for the classification (and therefore identification and differentiation) of securities amongst other financial instruments. This is not to be confused with the classification of *debt* securities – a robust classificatory methodology for the securities concept generally ought to solve any classificatory problems related to debt securities specifically, as the legal concept of debt (and the creation of debt securities specifically, as per § 4 2 of Chapter 4) is fairly clear.

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26 As opposed to a law of contracts.

27 Naude (2003) *TSAR*, see specifically § 1 and § 5; and T Naudé *The Legal Nature of Preference Contracts* LLD thesis Stellenbosch (2003) § 6 3 2, 248-262.

28 Naude (2003) *TSAR* 425-429.

29 Naude (2003) *TSAR* 430-431 [own emphasis].

30 See CG Van der Merwe *Sakereg* (1979) 46; or CG Van der Merwe *Sakereg* 2 ed (1989) 63.

It is submitted that use of the *Typenlehre* is perhaps the only manner in which the securities concept can be meaningfully and robustly circumscribed. A typological circumscription has the ability to inject *substantive* content into the concept without overly formalising it. If such a circumscription can be achieved, it would effect much needed certainty in current South African law in so far as it relates to securities.

At its core, the *Typenlehre* is a methodology for the legal classification of recurring patterns of juristic facts (as legal phenomena) to which a particular policy-mix of legal norms and rules must be applied. It stands in (partial) opposition to the traditional classification of legal phenomena into “concepts” according to the presence of fixed and determinate criteria, only recognisable by the presence of *all* those criteria (“only then and then always”).[31]

The best example of this traditional approach is the essentially Pandectist identification of contract types and sub-types using the *essentialia-naturalia* methodology. Identification of contract types in this manner paves the way for the nuanced application of broader norms through imposing a customised set of legal incidents upon such a contract. The specific subset of *naturalia* is determined by the *essentialia*. The *essentialia*, as the “bare bones” of a contract, are loosely understood to be the manifestation of the parties’ basic contractual purpose. That purpose is the teleological catalyst for the application of the set of norms which ought to regulate how that contract functions in typically occurring matters not provided for in the contract’s express terms.

The application of these norms is therefore concretised in the legal incidents of a contract (as the black letter law expression of the law's policy positions on “those kind of contracts”). The *essentialia* determine the contract type, and each type has a particular set of legal incidents that apply to it.[32]

The *Typenlehre* opposes this type of formal and mechanistic “conceptual subsumption” of juristic fact-patterns into *concepts* (*Sinnentleerung*) to which the same rules, teleological approach and set of norms will be applied in all cases. Concepts rely on a scheme in which all criteria for classification must be unfailingly met before classification, and norm application, can take place. Critique of “*Sinnentleerung*” includes for instance that in the face of legal or even merely commercial variability, such “sets” of norms and rules will sometimes be inaccurately or inefficiently applied. Further it has

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31 Larenz *Methodenlehre der Rechtswissenschaft* 104.

32 See T Naudé “The function and determinants of the residual rules of contract law” (2003) *South African Law Journal* 820 for a general exposition; see also T Naudé & GF Lubbe “Exemption clauses – a rethink occasioned by *Afrox Healthcare Bpk v Strydom*” (2005) 5(1) *South African Law Journal* 441 445-455; Joubert (1989) *TSAR* 576; and finally Naudé (2003) *TSAR* 414, providing as follows:

> “[The *essentialia-naturalia* model] rationalises the law by norm reduction, which mediates understanding and application of the legal rules involved. This is does by identifying a set of residual terms (*naturalia*) applicable as a matter of course to transactions falling within the parameters of the *essentialia*, unless inconsistent with the [parties’] agreement…It also facilitates a differentiated treatment of the separate types of contract identified in terms of this model, based on the typical party interests and purpose and policy considerations involved.”

been said that within this mode of conceptual subsumption (of juristic fact-patterns) new and "mixed" fact patterns cannot be adequately managed or accommodated. Also, it can hinder legal development by discouraging the recognition of emergent difference in legal phenomena.

As related to contract law, it could also be argued that this approach is an awkward fit to a law of contract as opposed to of contracts, where freedom of contract allows almost infinite variability.[33] This is why the typological methodology finds such ready application in opposition to the Pandectists' formalistic contract classification. It is important to note, however, that all these criticisms are not an argument that the typological method should be the standard point of departure for legal classification. Instead, they represent an indication of the limitations of the traditional "only then and then always" approach, specifically for hard cases, and conversely of the usefulness of the *Typenlehre* in those cases.

The *Typenlehre* takes a different methodological approach to grouping legal phenomena for the application of legal rules and norms. Terminologically, the typological approach uses the word "concept" to refer to a legal phenomenon which can indeed be described by an exact enumeration of characteristics or criteria, and thereby adheres to the "only then and then always" mode of classification (i.e. *Sinnentleerung*).

However, in contrast to concepts, the *Typenlehre* further accommodates *types*. Types and concepts are not opposites. There can be overlap as a type becomes increasingly definite and approaches a concept, or where one or two of a concept's criteria may not be perfectly definitive, such that it approaches a type. Furthermore, there are no absolute boundaries or bright lines between types, such that "types may blend into each other due to the variability of their elements", resulting in ranges of types (*Typenreihen*).[34] This concept-type dichotomy within the methodology can be understood as follows:[35]

> "Adherents to the *Typenlehre* distinguish concepts from types. They point out that there are various legal terms that cannot in fact be defined by a complete enumeration of exact, strictly conceptual characteristics, the application of which is a simple matter of logical subsumption. Rather, some terms are defined by indicative or symptomatic factors that do not necessarily all have to exist and which can exist to a greater or lesser extent (their characteristic criteria are therefore gradeable). These terms are called *Typen* or types to distinguish them from concepts. Types are not defined, but described, in terms of the aforesaid indicative

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33 For these criticisms see Naudé (2003) *TSAR* 422; Naudé *Preference Contracts* 249; and Joubert (1989) *TSAR* 577-578.

34 Naudé *Preference Contracts* 253; and Naudé (2003) *TSAR* 424.

35 Naudé *Preference Contracts* 250-251; and similarly Naudé (2003) *TSAR* 422-423.

> factors or concrete examples…The question is whether the typical characteristics of the type are present to such a degree that the factual situation as a whole corresponds to this type."

The method prescribes a comparison of types, with the focus of the analysis on what the overall picture indicates – a *Typenvergleich* (i.e. comparison of types), looking for a coherent *Gesamtbild* (i.e. overall impression). This comparison uses existing and identified types, with help from established concepts as well as previously settled instances.[36] It identifies a type based on *indicia* of that type, all of which need not be present. When all the presenting *indicia* indicate a *Gesamtbild* that suggests the phenomenon is of a certain type, it is classified as such. This paves the way for the application of the appropriate subset of rules and policy that *should*, teleologically, attach to such a type.

As a point of departure for the recognition and constructing of types it has been stated that:[37]

> "[t]ypes are therefore more 'open' than concepts. The application of the type requires a value-judgement based on social experience and views of the marketplace. *The law builds the type with reference to the consequences connected to it*. Therefore, when considering whether a concrete example falls under the type, one must look to the purpose of why the law wants these consequences to attach to this type. *Types and typological thinking therefore force one who applies the law to always consider the purpose of legal conceptualisation and the appropriateness of a rule's legal consequences.*"

Seen thus the *Typenlehre* does not seem to do away with legal certainty (as it has been accused of doing). It is common cause that legal concepts must be defined as exactly as possible, but only *in so far as is possible*. Where this is not practical or possible, the complexity of reality must at least be recognised and reflected in the law.[38] This is what the *Typenlehre* attempts to achieve. It is argued below that this is also the only effective way to approach the identification and differentiation of securities from other, often similar, financial instruments. The aim of this section was to address arguments to effectiveness and show that the *Typenlehre* as applied to securities law can be a useful and powerful tool for drawing a juridical frame around the securities-concept (or, rather, -*type*). The next section aims to make a case for the appropriateness of the methodology to securities.

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36 See Naudé *Preference Contracts* 250-252 & n 269; Naudé (2003) *TSAR* 423-425; and Joubert (1989) *TSAR* 577-578.

37 Naudé *Preference Contracts* 252 [own emphasis].

38 This argument is best stated in Larenz *Methodenlehre* 110.

6 2 2 The case for a typology of securities

Financial instruments include shares, depositary receipts, debentures, interests in a collective investment scheme, derivatives, certain negotiable instruments, money market instruments such as certificates of deposit, as well as, potentially, a number of other instruments or “arrangements”. Which of these instruments are securities for the purpose of the application of law?

Securities, as a sub-class, are extremely difficult to identify and differentiate from other financial instruments. However, this is not immediately obvious and at first glance no statute appears readily to provide the answer. In terms of currently enacted law, sections 1 of the Companies Act of 2008, the Financial Markets Act of 2012 (“FMA”), and the Securities Transfer Tax Act[39] (“STTA”) all provide a definition of “securities”. Yet each of these acts defines the concept enumeratively rather than substantively, providing a list of instruments which are to be considered securities for the purposes and application of that particular act. Central to the broader issue is that the definition in each act differs in scope.

The defining provisions of both the Companies Act and the FMA have been dealt with above.[40] The STTA, in s 1, defines securities as follows:

> “**'security'** means-
>
> *(a)* any share or depository receipt in a company; or
>
> *(b)* any member's interest in a close corporation,
>
> excluding the debt portion in respect of a share linked to a debenture…”

From the above, shares and receipts issued by central securities depositaries to evidence secondary immobilised or dematerialised securities are clearly securities. Yet for the purposes of the FMA, the shares of shareblock companies are excluded, whereas the STTA makes no such exclusion. Additionally, the latter act also includes members’ interests in a close corporation, but it is the only act to do so. Debentures, bonds and even notes (terms which effectively denote the same type of instrument and are legally indistinguishable)[41] are also clearly securities, yet they – in turn – are excluded from the STTA. The FMA does consider debentures to be securities and goes much further to include also a broad range of other financial instruments, but it seems to exclude any issued by private companies. This forces one to conclude that whether a particular financial instrument is, or

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39 25 of 2007.

40 In § 6 1.

41 Therefore all references to this type of instrument will be limited to “debt securities” unless the context requires otherwise.

is not, a security is contextually variable, and contingent on the application of the act or legal rule in question.

However, this alone does not sufficiently resolve the matter. Both the Companies Act and the FMA contain plenary, catchall provisions when dealing with securities. In the latter, there is ss (d) and (e)(iii) of s 1 (*v.* "securities); in the former, s 43 ostensibly includes "any other securities other than the shares of a company". Other than the *eiusdem generis* canon of construction, there is nothing contained in the common law, nor any case law, that allows the law to make a determination about whether a particular legal arrangement or interest will fall into this category.

Determining the common characteristics possessed by the list of securities that invariably precede such a plenary phrase – and which must ostensibly be given an *eiusdem generis* meaning – is difficult. One cannot argue that they are all investment instruments. First, one cannot satisfactorily demarcate the meaning of "instrument" in this context. Second, there are many other types of instruments which can be used for investment purposes, including most notably Krugerrands, futures, foreign exchange, contracts for difference, money market instruments not making use of the custody and administration of securities architecture of the FMA, or even postage stamps.

Similarly, an argument that they are all investment *contracts* falls prey to the same critique, as well as the problem that neither shares nor all interests in a collective investment scheme are legally classifiable as contracts.[42] Convertible securities further muddy the waters in this regard. One cannot argue that they share a similar set of *essentialia* because they plainly do not. One can also not argue that they are all actively traded investments, primarily because this is also in many instances patently untrue, most obviously in the cases of securities of non-listed public companies or private companies. Additionally, other financial instruments, such as contracts for difference ("CFDs"), *are* actively traded investments, but in all likelihood not securities in the true sense. In sum, almost all attempts to find a definitive base-line meaning for the term securities ends in frustration.

This may seem trivial – surely, for instance, if something is called a debenture, it can with certainty be stated that it is a security? Unfortunately – (1) in the absence of definitive case law or academic attention (as is the case);[43] (2) in light of the "esoteric, fast-developing and highly-globalised world of the finance industry" and its "fast developments of financial instruments, transactions and

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[42] *Smuts v Booyens; Markplaas (Edms) Bpk v Booyens* 2001 (4) SA 15 (SCA) 22.
The term "investment contract" is in fact *the* classificatory "gate-keeper" in US jurisprudence – see § 6 3 3 below.

[43] Whereas in the United States, for instance, "there have been no fewer than 792 cases decided and over 300 law review articles written in which either the '33 or '34 Act definition of a security has played a prominent role" – TA Gabaldon "A sense of a security: an empirical study" (1999) 25 *Journal of Corporation Law* 307 308.

techniques";[44] and (3) considering the prevalent risk of financial fraud and the lesser systemic risks of mere financial irresponsibility[45] – the problematic consequences of the lack of firm doctrine of securities in South African law[46] are not so trivial. At least, in order to prevent fraudulent or unscrupulous simulations, give meaningful effect to the policy objectives of financial and securities regulation, and (somewhat counter-intuitively) to prevent an uncertainty-driven chilling effect on healthy financial innovation, South African law must be capable of classifying, identifying and distinguishing securities from other financial instruments.

As a further illustration of the problem, consider the case of derivatives. The central aim of derivatives is to relocate and spread the risks of changes in certain financial variables between parties.[47] Derivatives include futures, contracts for difference ("CFDs") and other forward contracts (operating both in the commodities and direct derivatives markets),[48] options, swaps, caps, floors, and ostensibly any other instrument "whose value depends on or is derived from the value of one or more underlying asset, rate or index, on a measure of economic value or on a default event" and which entails the "creation of rights and obligations" around this.[49] Through the combination as well as repackaging of these "traditional" derivatives into new derivatives, the potential variability of these financial instruments in their own right is exceptionally complex.[50]

As seen, the FMA contains by far the broadest definition of securities. The Act clearly states, *enumeratively*, that the term "securities" includes "derivatives".[51] However, substantively, it is uncontentious to assert that not all (if any) derivatives possess the qualities of registered (or, for that matter, bearer) securities. Swaps (although even the swap itself is subject to great fluidity in terms

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44 H Cousy "The delicate relationship between law and finance: the classification of credit default swaps" (2014) *Tydskrif vir Suid-Afrikaanse Reg* 227 227.

45 Specifically regarding debt securities: see for example HC Nel *The Final Report of the Commission of Inquiry into the Affairs of the Masterbond Group and Investor Protection in South Africa* (2001), Vol 1-3; or essentially any informed account of the 2009 Financial Crisis.

46 Addressed by Chapter 4 and to some degree also Chapter 5.

47 AW Oguttu "Challenges in taxing derivative financial instruments: international views and South Africa's approach" (2012) 24 *South African Mercantile Law Journal* 385 389.

48 Goode *Commercial Law* 156.

49 Section 1 of the Financial Markets Act (*viz.* "derivatives").

50 Oguttu (2012) *SA Merc LJ* 387.

51 Which, interestingly, does receive a substantive rather than enumerative definition: see s 1 *viz.* "derivative instrument", which reads:

"'**derivative *instrument***' means any—

(*a*) financial *instrument*; or

(*b*) contract,

that creates rights and obligations and whose value depends on or is derived from the value of one or more underlying asset, rate or index, on a measure of economic value or on a default event…"

of its possible rights and obligations)[52] are instruments that can fulfil any number of functions. These include a risk management function (for instance, credit-default swaps effectively insure against the risk of default), a financial-engineering function (for example allowing the holding entity of an SPV-issuer of an asset-backed security to increase leverage on the underlying assets through "synthetic securitisation"), or an investment function (such as "total return swaps" which resemble the leasing of securities and can be, and are, actively used to create portfolio gains by individual and institutional investors alike). Additionally, the parties at *both* ends of a swap agreement may cede their rights freely, unlike the case of registered and bearer securities, where the issuer as counter-party remains fixed.

There are strong arguments in favour of regulating certain types of swaps as insurance contracts rather than securities,[53] as well as some international debate as to whether swaps in general should be regulated as securities, forward-contracts or as *sui generis* instruments.[54] There seems also to be, for instance, general international consensus (at the very least amongst the Anglo-American oriented jurisdictions) that futures and other forward contracts are not securities in the strict sense.

Options present a specifically illuminating problem in that, at least, some options to take up securities could possibly also be considered securities in that stricter sense, but others perhaps not. The almost excessively broad framing in the FMA of the narrow securities concept is certainly justified in terms of the purposive thrust of the Act. However, any abstractions about securities based on this observation must be approached with caution, as the legislature has surely strained the securities concept to cover its regulatory intent.

More broadly, the problem of derivatives reveals that (1) securities can be, and are, differentiated from other financial instruments; (2) the term is contextually variable, so that a functional

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52 For a very detailed (although somewhat dated) account of swaps, their high degree of variability and their legal nature in South African law, see FR Malan & W Faul "Legal aspects of 'swaps'" (1992) *Tydskrif vir Suid-Afrikaanse Reg* 394.

53 Cousy (2014) *SA Merc LJ* 223-235, also discussing specifically CDSs. However, see Malan & Faul (1992) *TSAR* § 5, as well as, therein, comments of the English courts in *Hazell v Hammersmith and Fulham London Borough Co* 1990 3 ER 33 (QB); 1990 3 All ER 66 (CA).

54 See for instance WE Gibson "Are swap agreements securities or futures? The inadequacies of applying the traditional regulatory approach to OTC derivatives transactions" (1999) 24 *Journal of Corporation Law* 379; and Malan & Faul (1992) *TSAR* § 5, specifically 408.

classificatory framework *must* be teleologically flexible;[55] and (3) South African law is in need of more clarity in this field. The ability of the domestic law to make distinctions such as these is vital to its role in preserving systemic stability in the financial sector through effective, accurate and ideally pre-emptive regulation. Even more pressing, however, is the need to identify the core concept that underlies designation as a security. Having done so, the law can improve its current treatment of financial instruments and *proactively* address potential issues regarding new financial instruments without needing to change the legal framework currently in place.

Classification, and by implication identification and differentiation, is not impossible. A potentially workable framework for the identification of securities has already been tentatively suggested, based on a flexible set of *indicia* which need not all be present, but which "form a range of factors whose presence typifies securities".[56] This approach was outlined in an earlier work by this author in the context of a comparative study of the US and domestic regulatory implications of investment (or equity) crowdfunding, where the types of interests offered on such online crowdfunding platforms often resemble, to a greater or lesser degree, instruments that have been classified as securities.

The caveat placed on these "tentative suggestions" was that "further research will provide more definitive answers".[57] Before this approach can be made more definitive, it must be understood. The argument begins with a characterisation of the classical security, the share,[58] from which flows a number of observations. First, securities are invariably premised upon a right or a bundle of rights, but it is the manner in which the financial instruments containing such rights are structured (or "packaged and evidenced"), rather than the actual rights, that typify them as securities. Second, they are so structured partially in order to facilitate the trading of these instruments at high volume and frequency. Third, the instruments themselves have no intrinsic value – their value is contingent on other factors (such as the market value, financial or economic position, or creditworthiness of the issuer), or upon the value or change in value of other underlying instruments or measures. Fourth, they are typically quasi-fungible (fungible to the extent that such instruments are issued in multiple units, and units *of the same issue* are economic equivalents). Fifth, in the normal course of

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55 The primary purpose of the FMA is to regulate financial markets, not financial instruments. A derivatives market, such as the JSE's futures trading platform SAFEX, must therefore fall within its ambit. To achieve its policy goals it has *nominally included* all derivatives into *its* securities concept. Its regulatory ambit also includes insider trading, which further requires the regulation of a wider group of instruments than what traditionally would be regarded as securities.

This illustrates the need not only for flexibility regarding the term "securities" in general, but specifically for *teleological* flexibility. In other words, the law must be able to classify securities not only (if at all) in general, but apply *specific* rules relating to securities appropriately, and in line with the desired legal outcomes of the context in question. Thus, for example, what must be classified as a security to implement the policy aims of the FMA is not necessarily what must be classified as a security for the Companies Act.

56 PJ de Beer "The law of crowdfunding: challenges to the South African securities law – a comparative perspective" (2013) 1(2) *Penn Undergraduate Law Journal* 19 53. See § V ss D (47-54) for the broader argument.

57 De Beer (2012) *PULJ* 54.

58 De Beer (2012) *PULJ* 51-52.

commerce, instruments which are represented to be securities, typically are securities.[59] On this basis, a classificatory benchmark is proposed:[60]

> "These attributes [of shares] are useful in determining what forms of investment crowdfunding interests (not readily classifiable under the Companies Act as securities) may be subject to securities regulation.
>
> In so doing, they form a range of factors whose presence typifies securities. Thus, an inquiry centred around the *configuration* – not necessarily the content – of these interests could be applied as follows:
>
> [1] The nature of the interest obtained – debt, equity, mere profit-sharing and so forth (as opposed to consumer interests such as products);
>
> [2] How the rights and duties pursuant to the interest are packaged [by asking]:
>
> [2.1] Is it structured in such a way that would typify it a security?
>
> [2.2] Is it evidenced in such a way that would typify it a security?
>
> In answering these two questions [2.1 & 2.2] regard must be had for the following:
>
> [a] Has the interest been designed to be facilitative to trading?
>
> [b] Does the interest create a degree of notional removal from the underlying assets it confers rights to, and is this apparent from how it is evidenced?
>
> [c] Is the interest fungible?
>
> [d] Finally, does the presentation of an interest as a security flow from the type of transactional relationship that would render it likely to be a security?"

In the form found above the approach is at the very least too simplistic, if not in some respects inaccurate. However, it is proposed that it can be improved by refining and expanding it. It can then be restated in the language of the typological approach. The jurisprudence of the *Typenlehre* can be effectively used for the classification of certain financial instruments as securities. The approach set out above is particularly suitable to be so adapted. Once in such a form, it could enable one to draw from the pre-existing body of South African legal jurisprudence without the need to establish or interpolate a new doctrine or theory into the current domestic legal framework.

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59 De Beer (2012) *PULJ* 52-53.

60 De Beer (2012) *PULJ* 53-54 [own numbering].

6 3 Formulating a *Typenlehre* for the classification of securities

As already observed more than a century ago:[61]

> "The term [securities] is not a term of art, but only a word of description. It is a commercial word which will vary with the history of commerce."

Undoubtedly this is true. Nonetheless, "securities" remains the operative term on which the application of a great number of legal rules depends, and it is central to the workings of many others. The law must be able to establish what this term encompasses (or does not) within any given factual matrix. The theory of types allows this and yet still retains the fluidity and capability to adapt along with commerce, as it must be able to do.

The strength of the theory lies in its teleological policy-consciousness and its ability to facilitate a high degree of legal certainty whilst dealing with non-uniform legal phenomena. This is key to robustly accommodating new or mixed factual matrices, which tend to arise regularly in the financial sphere. A *Typenlehre* of securities is thus a highly apt methodology with which to reconcile a slow-moving regulatory legal paradigm with a fast, ever-changing, innovative commercial reality.

First, however, the relationship between the *Typenvergleich* (comparison of types) and both (1) the broad, free-standing and (2) narrow, statute- or rule-bound securities concepts, as posited in Chapter 3[62] must be clarified. Each statutory definition indicates a particular narrow version of the securities concept. However, invariably, each such a definition also contains a reference to the broad securities concept. This is typically the *eiusdem generis* "any other instrument" or "any other security" phrase. This illustrates the usefulness of the *Typenlehre*'s teleological dimension in two important ways.

On one level, the methodology enables a determination to be made whether a particular financial instrument (or more generally a legal phenomenon) which is *nominally called* by any of the names enumerated in a particular securities-related act is in fact such an instrument in substance. If so, it can be determined whether the act must be applied to it. For example, on this first level it enables an interpreter of the Financial Markets Act to determine whether a financial instrument called a "note", is in fact a *note* for the Act's purposes, and do so on a teleologically sound basis. In other words, it informs determinations regarding the narrow securities concept as nominally enumerated.

On a second level, the *Typenvergleich* serves to make more direct sense of the legislature's use of a plenary, catchall phrase. Such a phrase necessarily refers to a general, or broad, securities

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[61] *Re Rayner* [1904] 1 Ch 176, 185 by Williams, LJ. Here the court was interpreting the meaning of the word "securities" as used in a will.

[62] See Chapter 3, § 3 1 3 3.

concept. Yet such a phrase must still be interpreted in an *eiusdem generis* manner and cannot simply refer to any financial instrument which falls within the broad securities concept. This much is clear from the material differences of existing statutory definitions alone. A phrase such as "and any other security" can only demarcate instruments (1) which are broadly securities, *and* (2) to which the application of the Act would be teleologically appropriate.

The *Typenvergleich,* on this second level, functions to *circumscribe* the broad securities concept, but never to identify it. The law can only classify securities in the narrow sense, as linked to a policy-position which manifests in a specific piece of legislation. Yet this analysis is also equally applicable to, and eminently useful in, classificatory problems in the application of legal rules which do not directly emanate from a particular statutory scheme.

In a sense, therefore, the free-standing general securities concept reveals itself to be somewhat of a legal fiction. No doubt there is, in reality, a broad securities concept, including all securities for all purposes. However, for legal (and classificatory) purposes, the general securities concept remains an abstraction which only becomes concrete once it is applied to a specific legal rule. At that point it has already "collapsed" into the narrow securities concept in question. In this way the broad securities concept is purely theoretical – a concept from which the law borrows, but one which it never delineates, in order to make more specific determinations on when a phenomenon should or should not be regarded as a security for a specific purpose or legal rule. The narrower securities concept is therefore the phenomenon that *is meant to be signified* (the teleology) by the particular legal *signifier* securities or security, in the particular context.

With this in mind, a *Typenlehre* for the classification and identification of securities can be established. This will be done in three steps. First, a framework will be established in order to clarify the basic outlines of the inquiry itself. Second, a number of non-variable characteristics (only then, but then not always, a security), serving to complement this framework, will be identified. Last, a number of variable *indicia* will be posited, to be used in whole or in part to determine whether a phenomenon under examination appears, holistically, to be as security or not.

However, it must be stated, in strong terms, that what follows is not only by far the most speculative, but also the least authoritatively corroborated aspect of this dissertation. The unchartered nature of the territory into which it ventures necessitates certain creative and lateral argumentation (or "*rationale Expansionskraft*").[63] This is justifiable only by the submission that these conclusions, while

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63 "Rational expansion", as per GF Lubbe "Die verpanding van vorderingsregte en die regsdogmatiek – quo vadis?" (1991) 2 *Stellenbosch Law Review* 135. See also Chapter 4, § 4 1 1.

presented as a proposed set of guidelines, are in reality merely a point of origin for such guidelines to *begin* to develop in South African jurisprudence.

6 3 1 Framing the classificatory inquiry

Before all else, a range of types must be identified – financial instruments. It is, however, beyond the scope of this work to fully develop this range of types any further than has already been done in § 6 1 above. Nonetheless, it is quite apparent that within this range are a number of categories and sub-categories of financial instruments exhibiting exactly the kind of fluid borders the theory of types is suited to. Some of these display non-variable characteristics that allow them to be classified as concepts within the *Typenlehre* modus. Others merely approach concepts, or defy classification as concepts altogether.

As should be clear, securities fall into the latter category, as the construct is definitely not reducible to a concept.[64] It follows that the most appropriate manner in which to identify a security within this broader range is to characterise securities at large as a *type* within the taxonomy of "financial instruments". This requires a classificatory judgement to be made by means of a comparison of types (*Typenvergleich*). Any such a "comparison-to-classify" will inevitably be contextually variable, implicating slightly different outcomes depending on the legal question, or dispute, at issue.

Thus the most basic consideration is what, exactly, is being analysed. Financial arrangements which are constitutive in nature (such as contracts) cause parties to such arrangements to become holders of *legal interests*. Such a legal interest may include rights, duties, as well as other legal competencies or liabilities which are not readily classifiable as personal rights or correlative duties in the strict sense. As a result of the fact that financial instruments are typically transactional in nature, there are invariably at least two parties to any given financial arrangement resulting in a financial instrument. Clearly, the various legal interests that can accrue to each party to such an arrangement have the potential to be diverse, variable and often quite intricate.

However, the present classificatory endeavour does not have to reckon with the full complexity of these arrangements. The inquiry at hand analyses only one aspect of any given financial arrangement that requires classification. That aspect is: whether the legal interest which accrues to the party or parties *on one side of the arrangement* is of such a nature that it is, holistically,

64 See the arguments in De Beer (2012) *PULJ* 19, specifically in § V.

classifiable as a security. If this is the case, the holder of that interest is a security-holder for the purposes of the law. The importance of this point cannot be overstated.

If this is the case, where does the analysis of the previous two chapters fit in? From these chapters, it can be said that it is in the nature of *registered* securities (which of course encompasses the result of bearer securities having been effectively dematerialised through the creation of a secondary, representative uncertificated security) that the incidents of execution over the underlying legal interest may be held by one person whilst the remainder is held as patrimony by another. A first step in developing a more general classificatory methodology is recognising that the term “security” (as a legal term) *primarily but not necessarily always* denotes a dichotomous construct, comprising the security instrument and asset respectively.[65] However, it must be noted that whilst the features of registered securities are strongly persuasive in the classification of a particular legal interest as a security, this is not always determinative.

Thus, despite the conclusions of Chapters 4 and 5, it may be that certain legal interests which do not fully evince the above qualities would still notionally qualify as securities. This is, of course, dependent on the context of the particular inquiry, and most exceptions are a product of the kind of legislative over-extension as is evident in the definition of the FMA. In its formulation, the act artificially extends the definition of securities to include many instruments which may not, in the purer sense, be classifiable as securities.[66] This demonstrates that an instrument which does not evince the characteristics of *registered* securities may still be appropriately classifiable, in a particular context and for a particular purpose, as a security.

These observations serve further to underscore the fact that any specific application of the proposed *Typenvergleich* must, more than anything else, be teleologically conscious. It also illustrates that the *relative* persuasiveness of each individual *indicium* posited in the sections that follow may, and indeed must, vary depending on the context in which and the reason why classification is required.

In this light, the subject (or point of departure) of the typological inquiry into whether a given legal interest is a security or not, can be framed as follows. What must be asked is whether:[67]

> *(1) with reference to the teleological imperative of the legal principles applicable to the legal question or context at hand, (2) a held legal interest (i.e. the position of a particular counterparty, as the result of a*

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[65] See Chapter 4, § 4 1.

[66] See § 6 2 2 above.

[67] The text which follows is original, and this formatting, and similar formatting throughout this chapter, has been chosen to emphasise the development of the classificatory methodology proposed.

given financial arrangement) displays a sufficient number of positively indicative characteristics for appropriate classification as a "security".

Thus, the object or phenomenon which must be classified is the *result* of a given financial arrangement – i.e. a "held legal interest". A further question is when the inquiry should be applied. To classify a particular legal phenomenon as a security, the comparison must be made not only with reference to the interest held, but also either: (1) at the moment at which the constitutive financial arrangement has created the legal interest, *or* (2) when the interest was last modified,[68] rather than the stage when the legal question or dispute itself arose.

From here the inquiry can be expanded upon, and guiding principles for the content of such a *Typenvergleich* can be formulated. It will require an extensive refinement of the "range of [structural] factors" discussed in the previous section, but will remain in keeping with the central idea that it is both the *structure, substance, and context* of the financial instrument which is determinative of its status as a security. Therefore: what are the *indicia* that would typically cause such a legal interest to be classified as a security?

It must again be stressed that what follows remains only a proposed factor-based comparison. It may be incorrect, it may only be partially correct, and it is certainly probable that, if ever put to use, this classification method will undergo continuous modification and development. At least, however, it may serve as a point of origin from which the inquiry may develop organically.

6 3 2 Only then, but then not always

The content of a *Typenvergleich*, or comparison of types, has been characterised as a collection of "indicative factors or concrete examples".[69] Given that quasi-fluid borders may exist between types, and indeed between types and concepts, the first question that arises is whether there are any fixed or immutable criteria that will always be indicative of securities.

It should be noted here that one should not presuppose that all securities present classificatory problems. It is submitted that equity interests – i.e. shares[70] and members' interests in a close corporation – usually do not. Shares originate from a fixed and discrete legislative scheme, which leaves no ambiguity about their legal status as securities in almost any context. The same cannot

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68 Accounting for the notion, as proposed in the previous chapter (Chapter 4, § 4 2) that certain rights may, *after* their inception, be converted into (or "encased" in) a security.

69 Naudé *Preference Contracts* 250-251.

70 As well as, potentially, a member's interest in a close corporation, as is the case for the definition of securities found in s 1 of the Securities Transfer Tax Act 25 of 2007. Again, teleological context, in the classificatory inquiry, is key.

necessarily be said for members' interests, but the law is typically explicit when these equity instruments are being addressed as equity *securities*, greatly limiting the ambit of any classificatory issues that may arise.

The most pressing issue is whether a particular factual matrix has given rise to a *contractual or partially-contractual* legal interest which is classifiable as a security. This matter, naturally, is central to this work at large, as it refers primarily (if not exclusively) to arrangements of debt. In this area the incidence of variability, in both form and function, is far higher. For this reason, the outlined classificatory scheme is of primary application to contractual securities and any other non- or part-equity securities such as hybrid and convertible securities.

Core to this classificatory issue is that, in contrast to equities, the rights and competencies of which the bundle comprises do not arise in a uniform manner. Typically, the personal rights underlying these securities (but also, in certain cases, other competencies such as status as preferred creditor upon insolvency) are created *within* the constitutive arrangement between the prospective security-holder and issuer. However, typically most competencies (and, it being unwise to exclude the possibility, perhaps also certain personal rights) will arise consequentially: as a *result* of classification – or classifiability – as a security.[71]

These *ex lege* consequences of the legal interest "being" a security: (1) supplement the complex of rights and competencies (for example, additional informational rights are afforded to the holders of company securities through s 26 and s 31 of the Companies Act of 2008); and (2) empower the issuer to add, voluntarily, certain rights and competencies (such as affording the holder of a company "debt instrument" a voting right in terms of s 43 of the Companies Act) to the complex. This is highly analogous to the imposition of a particular subset of *naturalia* upon certain contract types. The *ex lege* consequences in this context are simply the black letter articulation of the positive law's deeper policy positions regarding securities.

Therefore, in order to avoid circularity of logic in the classification process, no regard can be had to any consequential features of a held legal interest. These features presuppose the legal interest having been classified as a security. Such ostensible consequential rights can also be misleading. For example, a constitutive arrangement may *purport* to bestow a company voting right upon a creditor, but unless that debt underlies a company debt security, such a competency is not authorised by the positive law, and may well be void.[72] Thus the focus of the classificatory exercise must be on the aspects of the legal interest in question that flow directly from the constitutive

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71 See Chapter 4, § 4 1.

72 As illustrated in the second example in Chapter 4, § 4 2.

arrangement – i.e. personal rights and, in certain cases, comparable competencies (denoted collectively simply as rights going forward).

With this as background, a number of fixed and immutable properties of securities' underlying interest can be identified.

First, it is in the nature of all securities that they comprise a bundle of one or more personal rights[73] and other analogous competencies. Securities can never directly confer real, immaterial property, or personality rights (personality rights are in any event not directly patrimonial in nature). Generally, the following instruments are unambiguously considered to be securities: shares, debentures/notes/bonds, and dematerialised money market instruments.[74] Examples of rights associated with these established cases of securities include contingent rights to profit-sharing and capital gain (equities and equities issued as ICISs), or interest income (debentures, notes and bonds and, typically, money market securities). In this light it seems relatively uncontentious to assert that the only type of subjective right that can appropriately form the foundation of a security is a *personal right*. Thus the broader underlying interest of which the security is constituted must be structured around a personal right (for example an option), or a materially related set of personal rights (such as is the case for the other securities mentioned above).

Second, the underlying interest of a security is *primarily operative only against a specific counter-party, to the exclusion of all others.* This is inherent in the nature of personal rights, but where a number of personal rights are bundled together, they must still all be claims against the same counter-party. An analogous position exists with respect to any competencies arising from the constitutive arrangement.[75] In other words, irrespective of the arrangement which is constitutive of the underlying interest, the interest *itself* is a claim or set of claims against a single performance-debtor.[76] It would appear that any duties imposed by security-holdership would function in a similar manner. The use of "primarily operative" is important, as certain securities (most notably shares and members' interests in a CC) may also regulate aspects of the security-holder's relationship with other security-holders, but this is ultimately a secondary feature of these instruments, and has little to no relevance to the inquiry.

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73 See Chapter 4, § 4 1 2 for more detail.

74 Of course, as a prime example, the Financial Markets Act would appear to imply that a far greater number of different instruments are securities for its purposes. These should not be included here, the reasons for which will be become clear below.

75 See Chapter 4, § 4 1.

76 Typically, the underlying interest in a security also contains no reciprocity in the form of duties owed to the counter-party, but because it is typical and not definitive – this is dealt with at § 6 3 3 1 under "*Passivity*".

Third, it is relatively uncontentious to state that securities cannot be created by natural persons. The only possible issuers of securities at present appear to be: companies formed in terms of the Companies Act of 2008, which includes state-owned enterprises and entities such as the Reserve Bank, banks and other institutions also operating in conjunction with other legislation,[77] organs of state (most notably the Treasury) in terms of the Public Finance Management Act[78] and related provincial and local government finance legislation, collective investment schemes (typically also structured as "open-ended investment" companies, trusts, or combination of both),[79] and perhaps also other juristic or quasi-juristic persons. Thus, given this wide scope, it is more appropriate to refer to artificial legal persons, and not juristic persons.

From the above, a number of definite, immutable characteristics of securities can be identified:

1 securities are structured around a personal right, or a materially related set of personal rights which flow from a constitutive arrangement (irrespective of its nature or form) between the applicable legal interest-holder and a counter-party;

2 the underlying interest of a security – irrespective of its content – is primarily operative against a single counter-party, to the exclusion of others; and

3 that counter-party is always an artificial legal person such as an organ of state or a company.

This may seem obvious, but any working classificatory model that purports to be robust, must be built on the most basic of foundational attributes. These characteristics are common to all securities, and no held legal interest can be classified as a security without evidencing these qualities. However, the presence of these qualities does not automatically classify any given legal interest flowing from a financial arrangement, or any given financial instrument, as a security. These qualities simply mean: only then, but then *not* always.

6 3 3 Completing the classification: variable indicia

From here, the *Typenvergleich* moves into more variable territory. If the particular held legal interest in question satisfies the "only then but then not always" criteria above, one turns to the variable *indicia* in order, if necessary, to make a final determination. This is precisely *because* the

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77 See s 8(2) in conjunction with s 1's definitions of "personal liability company", "private company" ,"public company", and "state owned company" in the Companies Act of 2008; and the South African Reserve Bank Act, 90 of 1989.

78 1 of 1999.

79 JW Scholtz & DW De Villiers "Securities Services and Collective Investment Schemes" in JW Scholtz (ed) *Law of South Africa* 2 ed (2015) Vol 26 § 155.

indeterminable nature of the broad securities construct does not allow for it to be reduced, as it were, to a concept, and must ultimately be approached as a type. Vitally, it should be kept in mind at all times that the application of the *indicia* which follow are to be viewed through the teleological lens of the legal rule, and indeed the legal dispute, in question. This "[forces] one who applies the law to always consider the purpose of legal conceptualisation and the appropriateness of [the] rule's legal consequences".[80] The overall impression – i.e. the *Gesamtbild* – which emerges is what will indicate whether the legal interest under examination must be classified as a security for the purposes for which the question has been raised.

It is also important to note from the outset that what follows may appear to be overly-exhaustive, quite cumbersome, and at times rudimentary. However, the iterative and casuistic legal development that the *Typenvergleich* methodology requires for its effectiveness cannot be fully pre-empted or simulated here. It is also not possible to forecast the nature of future litigation over the products of future financial arrangements (which will drive its refinement). Thus, the objective in outlining the factors that follow is merely to put forward a certain number of guiding variables. These variables may or may not be useful or accurate in the event that this methodology is put to use in legal problem-solving. Thus, paradoxically, each of these factors stands both alone *and* in interdependence with others. This may not, at first glance, appear to be in keeping with the format in which it is presented, but as will be seen a thematic exposition makes the most sense.

The *indicia* provided are to be regarded as facilitative of classification – guidelines that *if necessary* provide assistance in forming a holistic classificatory determination. In certain cases, the *indicia* will be further split into constituent aspects. They are also placed into two thematic categories.

The first are *indicia* regarding the content and nature of the personal rights in question. Applied to a specific scenario, they ask one to look at the nature of the legal interest in question and speak to whether this interest evinces the qualities that are typical of the underlying interest in a security. Put differently, this portion of the inquiry asks whether the rights and competencies in question are appropriately able to form the underlying interest of a *security* per se.

The second category of *indicia* is more fluid. It is tempting to want to further categorise and classify these *indicia*, for example, into "structural", "environmental" or "evidentiary" subsets, respectively. Yet such further subdivision would not add sufficient value. These *indicia* are simply contextual. This second portion of the inquiry reveals whether, holistically, security-*like* rights and competencies have in fact and in law been made to form the underlying interest of a security proper. The order of the inquiry is not necessarily decisive as the search is for a coherent and meaningful *Gesamtbild* – a

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[80] As per Naudé, above at § 6 1 2 1.

holistic impression. All relevant aspects must be taken into account together, discounting all applicable teleological policy considerations.

6 3 3 1 Indicia regarding the nature of the underlying interest

Having established the fixed characteristics above, the following *indicia* centre around the legal interest – i.e. rights and competencies – that arises from a constitutive arrangement between the particular legal interest holder and the counterparty. As stated, it must analyse *one party's position* as the result of a legal arrangement, focusing on whether the right or materially related set of personal rights of the legal interest (that is held) is typical of a security. It also considers the question of duties as part of the legal interest. It further bears repeating that an absence of, or indication contrary to, any one or more of these *indicia* will not necessarily result in a negative answer on classification as a security, as this is done on the basis of the emergent *Gesamtbild* (i.e. the overall impression). It must also be noted that not all of these *indicia* will necessarily and always be relevant to a classificatory inquiry.

The following *indicia* regarding the nature of the rights are posited:

1 the personal right, or set of materially related personal rights, around which a security is structured, is of such a nature that:

   1 1 it includes one or more performances of a financial nature, comparable to those of known securities ["financial performances"];

   1 2 one of its primary functions for the holder is investment – i.e. the realisation of a net patrimonial gain flowing from claims to performance tenderable in the context of the overall financial arrangement ["investment"];

   1 3 performance is intended to be tendered over time at one or more certain or ascertainable future dates, rather than only immediately ["deferral"];

   1 4 it excludes any rights or competencies which would allow the interest holder to exercise direct control over the business or affairs of the performance-debtor ["control passivity"];

2 the content of a legal interest underlying a security is predominantly free of duties correlative to the right or related set of rights held by the performance-debtor ["duty passivity"].

The reasoning behind each of these *indicia* will be analysed below.

Financial performances

Vital to a functional typology of securities is some abstraction of the precise nature, or character, of the personal right, or materially related set of personal rights, around which the overall underlying interest of a security is structured. From established cases, the right or set of rights may include claims to:[81] the payment of a sum of money upon declaration of a dividend, or a similar distribution of a share of profits; payment of a sum of money representing a proportional claim to the residual assets of the issuer after liquidation;[82] or a combination of the above.[83] From these examples it is possible to infer that whilst performances need not be *monetary* per se, they must at least be financial in nature.

There is one notable exception – shareblock schemes. The definition of "share" in s 1 of the Share Blocks Control Act[84] is very wide:

> "**'share'**—
>
> (*a*) means a share as defined in section 1 (1) of the Companies Act in relation to a company, and includes a debenture of a company and a right to or an interest in any such share or debenture;
>
> (*b*) includes any other interest in a company;
>
> (*c*) does not include a right to or an interest in the assets of a company derived from a lease in respect of such assets…"

Clearly, this includes not only shares, debentures, interests in these securities, but also "any other interest in the company". Are these interests in a shareblock arrangement securities? To answer this question, they must be notionally declassified and designated only as shareblock instruments. The key difference between shareblock instruments and other securities is that a shareblock instrument must convey: (1) the right to use or occupy the immovable property of the shareblock company ("occupancy rights"), as well as (2) the right to vote at shareblock instrument-holders' meetings ("voting rights").[85] Monetary distributions (such as dividends or interest on loan capital) are not typically made to shareblock instrument-holders, as occupation is the core distribution[86] made by a

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81 The word "includes" is meant, with each of the four categories, to indicate that such a list is by no means a *numerus clausus* of the possible performances within such a category.

82 Both of these performances are typical of those found in equity instruments, specifically shares.

83 This is typically the case when dealing with convertible and hybrid securities.

84 59 of 1980.

85 See DW Butler "Time-Sharing and Shareblocks" in WA Jourbert (ed) *Law of South Africa 27* (2014) § 392 and § 393 respectively.

86 See s 1 *viz.* 'distribution' (specifically as including "the incurrence of a debt or other obligation by a company") as read with s 4 and s 46 of the Companies Act of 2008.

shareblock company.[87] Thus, the key performances the personal rights shareblock instruments are structured around are those which facilitate occupancy (i.e. analogous to the limited real right of *habitatio*, which is arguably difficult to distinguish from *usus* and *fructus*).[88] This is not financial performance.

However, a prerequisite for the functionality of the Share Block Control Act is the supplementary effect of the Companies Act (initially the 1973 Act and currently the 2008 Act). Shareblock companies are companies in the true sense. Thus any shareblock company must be incorporated under companies legislation.[89] A shareblock company is also not possible without a register of holders, and the 2008 Act makes provision only for a *securities* register. Further, whilst there was much uncertainty regarding the voting rights of holders of shareblock instruments other than shares,[90] voting rights for such holders is now facilitated by s 43(3) of the Companies Act. Thus one must conclude that, at least for the purposes of the Companies Act, these instruments are indeed securities.

From this hard case, three observations arise. First, it reinforces the point that a teleologically informed context- and policy-consciousness is crucial to the classificatory inquiry, and that different pieces of legislation give rise to divergent results. Second, it perfectly illustrates that the influence of any one single *indicium* should not be decisive to the outcome. Third, although the classification of pure equity-instruments as securities is typically unproblematic, the case of shareblock securities (as well as the case of inclusion of members' interests in a close corporation by the STTA) shows that a typological approach has supplementary value even when considering equity instruments.

Investment

This discussion will benefit considerably from comparable US jurisprudence. In the United States, s 2(1) of the 1933 Securities Act and the nearly identical s 3(a)(10) of the 1934 Securities Exchange Act contain a definition of a security (and whilst the former will be referred to, these definitions can be treated as equivalent for these purposes). Section 2(1) of the Securities Act reads as follows:

> "The term 'security' means any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or

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87 Butler "Time-Sharing and Shareblocks" in *LAWSA* § 394.

88 Van der Merwe *Sakereg* 374.

89 Butler "Time-Sharing and Shareblocks" in *LAWSA* § 358.

90 For more on this issue see again Butler "Time-Sharing and Shareblocks" in *LAWSA* § 360.

group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a 'security', or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing."

This definition appears to have all the hallmarks of a nominal, enumerative approach. However, the legislative scheme within which it functions has always been construed flexibly and with an eye for the economic reality of that to which it is being applied.[91] More importantly, the United States has the benefit of a rich and large volume of case law in terms of which a definitive test has been formulated and applied for the classification of securities. It pertains to an "investment contract", which has been treated as the definition's catchall provision.[92]

The original formulation of the test, which has remained substantially unchanged, is found in *SEC v Howey Co* where an "investment contract" is described as:[93]

> "[1] a contract, transaction or scheme whereby a person [2] invests his money [3] in a common enterprise and [4] is led to expect profits [5] solely from the efforts of the promoter or a third party, it being immaterial whether the shares of the enterprise are evidenced by formal certificates or by nominal interest in the physical assets employed in the enterprise."

This is known as the "Howey test". It is applied to the phrase "investment contract", which can be characterised as the US equivalent of the domestic definitions' typical use of "any other instrument" or "any other security". Somewhat counter-intuitively, this "investment contract" need not necessarily even be a contract in the strict sense. It should also be noted that it is the dominant but not the only legal test used for classifying financial arrangements as securities in the United States.

During the course of the judicial development of US securities law, the *Howey* analysis has revealed a number of shortcomings. This is evident from the fact that the courts have often reinterpreted the

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91 SA Miranda "Can pre-purchase entrepreneurial efforts satisfy the fourth prong of the *Howey* test? A critique of *SEC v Life Partners, Inc.*" (1997-1998) 38 *Santa Clara Law Review* 269 276-278.

92 See most notably JD Gordon "Defining a common enterprise in investment contracts" (2011) 72(1) *Ohio State Law Journal* 59; P McGinty "What is a security?" (1993) *Wisconsin Law Review* 1033; CW Schneider "The elusive definition of a 'security'" (1981) 14(2) *Review of Securities Regulation* 981 and CW Schneider "The elusive definition of a 'security' – 1990 update" (1991) 24(2) *Review of Securities and Commodities Regulation* 13, as well as for instance FHC Mazando "The taxonomy of global securities: is the U.S. definition of a security too broad?" (2012) 33 *Northwestern Journal of International Law and Business* 121; JC Nahr "What is a "security" for the purposes of the U.S. Federal securities laws? An analysis of foreign equity interests" (2002) 17 *American University International Law Review* 723; TA Gabaldon "A sense of a security: an empirical study" (1999-2000) 25 *Journal of Corporation Law* 307; JD Gordon "Common enterprise and multiple investors: a contractual theory for defining investment contracts and notes" (1988) *Columbia Business Law Review* 635; or MI Steinberg & WE Kaulbach "The Supreme Court and the definition of "security": the "context" clause, "investment contract" analysis, and their ramifications" (1987) 40 *Vanderbilt Law Review* 489; or RM Giampiccolo "The Second Circuit illuminates the *Howey* investment contract test's impact on novel financial instruments" (1986-1987) 52 *Brooklyn Law Review* 1001.

93 328 U.S. 293 (1946) [own numbering added for clarity].

formulation in *Howey* in order to judicially exclude certain arrangements from classification as securities. Courts have also resorted to the creation of rebuttable presumptions based on secondary inquiries. Most notable are the specialised supplementary inquiries developed in *Reves v Ernst & Young*[94] and *Landreth Timber Co. v Landreth*,[95] used for identifying debt and equity securities, respectively.[96] Most significantly, in light of the "irreducible tension between the securities laws' language and their purpose", the *Howey* approach is criticised as having the potential to apply both too widely and too narrowly.[97]

From a South African perspective there are also a number of caveats to an analysis of the potential usefulness of the *Howey* approach to the identification of securities. First, the *Howey* test is tied to a very specific statutory framework which has no equivalent in South African law. Moreover, this framework is underpinned by a Common law legal system which is markedly different from the South African dispensation. Second, the regulatory and institutional characteristics of the American financial marketplace are similarly not comparable to those of South Africa (most importantly in the the former's more interventionst approach and its use of the executive *and* administrative spheres of government). Third, the test does not function in accordance with a typological approach: although the test is flexible, *all* its elements must be satisfied for designation as a security. Fourth, the legislative intent of the 1933 and 1934 Acts is quite specific in being centred on *investor protection*. These acts attempt to achieve this primarily through enhanced disclosure requirements (including registration and prospectus requirements) and a more comprehensive remedial regime focused on fraud-prevention.[98] This is the teleological imperative that guides determinations on whether a transaction has created an "investment contract", so that:[99]

> "the definition of an investment contract should relate to the question about which contracts should have enhanced disclosure, rather than the level of disclosure required by other statutes and the common law for

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94 494 U.S. 56, 59 (1990), making use of the "family resemblance" approach, which begins with the presumption that a "note" *is* a security, which presumption may then be rebutted through demonstrating a resemblance to any item on a list of judicially developed exclusions.

95 471 U.S. 681, 683 (1985), which operates on the presumption that something called a "stock" must be an equity security (i.e. a share) if it further possesses the typical attributes of a share (specifically voting rights, income rights, the potential for capital growth, the ability to be used as real security and transferability).

96 For a thorough and robust discussion of this, see McGinty (1993) *Wis. L. Rev.* 1040-1080.

97 McGinty (1993) *Wis. L. Rev.* 1035-1040.

98 Gordon (2011) *Ohio State LJ* 63.

In keeping with the fact that the legislation originated as a response to the Great Crash and subsequent Depression of 1929 and onwards (see Chapter 2, § 2 2 3), the Howey Test has a distinctly *remedial* character in both its anti-fraud and disclosure aspects. Thus, it has been said to apply in a manner that is "results-oriented' (looking for fraud or a lack of investment merit-worthiness, and protecting "unsophisticated investors"), and its ambit is often *limited* by the presence of other remedies, specifically if another *lex specialis* is already applicable to the instrument in question – Schneider (1981) *Rev. Sec. Reg.* paras [E], [F], [J] & [K].

99 Gordon (2011) *Ohio State LJ* 72.

> most contracts. Consequently, in defining an investment contract, we should ask which contracts need the protection of the securities acts."

Consequently, any direct appropriation of the test, or elements of it, does not suit the South African context. Nonetheless, that does not mean that it cannot meaningfully contribute to the formulation of *indicia* which are suitable to South African law. As per the court in *Howey*, its central quality is that it:[100]

> "embodies a flexible rather than static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek to use the money of others on the promise of profits."

More recently, in *SEC v Charles E. Edwards*[101] the Supreme Court reiterated the need for flexibility, stating that the intention of legislature was simply to:

> "regulate *investments*, in whatever form that are made and by whatever name they are called."

This encapsulates a key insight to understanding the securities concept. Against the background of the previous two chapters, and even presently, it is easy to lose sight of the fact that, in law, the securities concept is primarily a *regulatory* concept. This is true regardless of the jurisdiction under discussion. Nonetheless, South African securities law creates a particularly strong impression of the securities concept as an enabling concept, allowing issuers to issue financial instruments that have certain qualities. This is further evidence of the marked influence of company law on its domestic development, and one must concede that securities do indeed have an empowering facet, the best example being that a company debt structured as a "debt instrument" may confer voting rights.[102]

Yet the principal legal function of the securities concept is to articulate and implement a particular legal policy position. It does this by facilitating the recognition that certain legal interests have a particular set of characteristics that require both general and bespoke corrective regulatory intervention (for example to protect investors and reduce systemic financial risk). This recognition allows a *grouping* (as "securities") of all legal interests that display those characteristics, so that recurring factual matrices belonging to that group may be subjected to a certain collection of specific corrective legal rules. This is why, for example, the security concept activates tax regulation,[103] securities exchange and securities' custody and administration regulation,[104] the regulation of

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100 *SEC v Howey* 328 U.S. 293 (1946) 299.

101 540 U.S. 389, 391 (2004) 391.

102 As per s 43(3) of the Companies Act 71 of 2008.

103 Through the Securities Transfer Tax Act 25 of 2007 (or "STTA" as above).

104 See most notably Chapters III, IV & V of the Financial Markets Act 13 of 2012.

securities market abuses such as insider trading,[105] regulation by disclosure of holdership,[106] the regulation of information provided to investors,[107] and fundamental transactions regulation.[108]

In this light, three of the elements of the *Howey* test illuminate certain core characteristics which can be used, with modification, to typify securities and substantiate aspects of the current, rights-based, portion of the typological inquiry. These are the "expectation of profits", "from the efforts of the promoter or third party" and the "common enterprise" elements of the *Howey* test. These will be discussed as and when relevant to the formulation of the proposed typology.

The first relevant factor is the contribution of "the expectation of profits" to the *indicium* presently under discussion – investment. It is somewhat trite that securities are used for investment. The rights around which securities are structured are the source of the economic end-benefits which accrue to the security-holder. They are the foundational components of any security. This links strongly to the idea that for their holders, securities are, primarily, investments of a particular kind. However, it is obvious that "investment" is not a sufficiently definitive characteristic. Securities are not the only means of "investing", and even the simple purchase of art or immovable property can fulfil the same function.[109] However, this does not change the fact that one of the many *indicia* that typify a security is that the underlying rights should appear to facilitate investment. What does that mean?

When interpreting the meaning of "in the expectation of profits", the US courts have framed the term "profits" very widely, including the use of an asset such as a recreational facility (but only where it is *mainly* for investment purposes rather than personal use),[110] capital gain on the sale of an asset,[111] and more traditional income and capital gains on an investment's value.[112] The return on the investment does not have to be monetary.[113] Although such a construction of "profits" is perhaps too wide for the South African context, the earlier discussion on shareblock instruments shows that the classificatory context will ultimately determine what is too wide or narrow a construction.

What is clear is that the primary function of investment is "profit" of a sort. This is best expressed as a net economic return on the counter-value provided for the security. A more legally appropriate

105 See most notably Chapter X of the Financial Markets Act.

106 See s 1 (*viz.* "beneficial interest") read with s 56 of the Companies Act 71 of 2008.

107 See Chapter 4 of the Companies Act.

108 See Chapter 5 of the Companies Act.

109 See also § 6 2 2 above.

110 Schneider (1981) *Rev. Sec. Reg* 984, § C; and Schneider (1991) *Rev. Sec. & Comm. Reg.* 15 & n 16.

111 Schneider (1981) *Rev. Sec. Reg* 984, § C.

112 I.e. "earnings" and "capital appreciation" – see for instance *United Housing Foundation, Inc. v Forman* 421 U.S. 837 (1975) 855-857.

113 Miranda (1997) *Santa Clara L. Rev.* 283.

construction of this characteristic (domestically) is that the right, or materially related set of rights, at the centre of the held legal interest under inquiry should appear to be intended to *realise a net patrimonial gain*. In other words, the purpose of the rights should be the achievement of a benefit, and that benefit must be a *net* benefit in the broader scheme of financial arrangement with the relevant counter-party or -parties. The gain itself must also flow from the claims of the interest-holder as creditor to both present *and future* performances. Ultimately, it highlights not only that investment is core to the securities concept, but also that the type of profit envisaged by investors is, in light of the complex modern financial marketplace, a fluid concept.

Whole or partial deferral

Given that securities primarily facilitate investment, framed as a net economic gain in the broader scheme of the arrangement, it is logical that the gain should have a temporal component.

It is uncontentious that most securities have an intended lifespan, which can either be open-ended (such as shares or perpetual debt securities) or closed (such as "vanilla" debt securities). The lifespan of an open-ended security is naturally contingent on the lifespan of the performance-debtor. The lifespan of a closed-ended security depends on its performances. It may be extinguished when performance becomes due and is discharged, or – if comprised of a set of multiple, iterative performances – when all intended performances have been discharged. It may also make provision for early termination or redemption. In either case, fundamental to securities is that the performance or set of related performances is to be tendered at one or more certain or merely ascertainable future dates. This does not exclude the possibility that a portion of the performance may take place immediately: as long as future performance is a component of the underlying interest this *indicium* will favour an affirmative classificatory outcome.

Control passivity and *duty passivity*

These two *indicia* will be discussed together, as they are both manifestations of the same underlying property of securities – passivity. Passivity is a vital concept in understanding what differentiates (most) securities from other financial instruments and arrangements. The *Howey* test is again very useful in this regard. This property is most clearly illustrated through a critical analysis of the "solely from the efforts of the promoter or a third party" requirement, its (historical) connection with the "common enterprise" requirement and the exact meaning of *enterprise* in this context.

Beginning with the "solely from the efforts of the promoter or a third party" requirement, it appears that, over time, US courts have tended either to ignore the word "solely", or read it to mean something less, such as "largely" or "predominantly".[114] With this in mind, the seminal formulation appears to be found in *SEC v Glenn W. Turner Enterprises, Inc.*, as a question of:[115]

> "whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise."

Further support for this approach is found in *SEC v Koscot Interplanetary, Inc.*, where the court rejects the notion that:[116]

> "the exertion of some effort by an investor is inimical to the holding that a promotional scheme falls within the definition of an investment contract."

Ultimately, as per *SEC v ETS Payphones, Inc.*:[117]

> "the critical inquiry in determining whether investors were dependent on the 'efforts of others' for their returns is how much, if any, *control* investors had over the operation of the business or enterprise expected to generate their returns."

Moreover, it appears that "efforts" in this regard must be of an *entrepreneurial* nature,[118] as it is fundamental to the notion of securities that the "investors provide the capital and share in the earnings and profits; [whilst] the promoters manage, control and operate the enterprise".[119]

Despite the attenuating effect of the *Glenn* and *Koscot* formulations, its outcomes have still not escaped criticism. This is best illustrated by the argument that it opens the door for certain franchise-based interests (specifically those of franchisors) to be inappropriately classified as securities.[120] Yet it remains an important feature of the inquiry, and for good reason. To grasp the import and utility of the requirement (and its attenuation), its relationship with another *Howey* requirement – "commonality" – must be discussed. This requirement is complex, has been applied differently by different courts in the US, and is described as interpretively "troublesome".[121]

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114 Schneider (1991) *Rev. Sec. & Comm. Reg.* 15, citing *Bailey v J.W.K. Properties Inc.* W.D. Va. 1989, and others; Miranda (1997) *Santa Clara L. Rev.* 283-284; and the analysis of McGinty (1993) *Wis. L. Rev.* 1048-1052.

115 474 F. 2d 476, 482 (9th Cir.) – see Schneider (1981) *Rev. Sec. Reg.* 984, § D; and Schneider (1991) *Rev. Sec. & Comm. Reg.* 15.

116 F.2d 473 (5th Cir. 1974) 479.

117 300 F.3d 1281 1353 [own emphasis].

118 See *United Housing Foundation, Inc. v Forman* 421 U.S. 837 (1975) 852 and *International Brotherhood of Teamsters v. Daniel* 439 U.S. 551 (1978) 561, as discussed in Miranda (1997) *Santa Clara L. Rev.* 286.

119 *SEC v Howey* 328 U.S. 293 (1946) 300.

120 See Schneider (1991) *Rev. Sec. & Comm. Reg.* 16.

121 Schneider (1981) *Rev. Sec. Reg.* 984, § B; Schneider (1991) *Rev. Sec. & Comm. Reg.* 14; McGinty (1993) *Wis. L. Rev.* 1083-1084; and Steinberg & Kaulbach (1985) *Vand. L. Rev.* 519-521.

In essence, a commonality analysis centres around whether, and how, both the risk of loss and potential for gain are shared between parties. Specifically, its purpose is to establish whether an investment is the type "in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment".[122]

However, the court in *Howey* did not explain or define the commonality requirement. Further, there is widespread disagreement regarding whether "vertical" or "horizontal" commonality is required. In this regard the US courts "are not only split; they are fractured".[123] Although the distinction is, for present purposes, of lesser importance there are:[124]

> "three basic definitions. Horizontal commonality focuses on the horizontal relationship between investors…[and] requires an enterprise in which the investors' contributions are pooled, and the fortune of each investor depends on the success of the overall venture…By contrast, vertical commonality focuses on the vertical relationship between the investor and the promoter. The vertical test defines a common enterprise as one in which the investor is dependent on the promoter's efforts or expertise for the investor's returns. Broad and narrow versions of vertical commonality exist. The broad version requires that the investor's fortunes be tied to the efficacy of the manager's efforts. By comparison, narrow vertical commonality requires that the investor's profits be tied to the manager's profits – i.e., they must rise and fall together."

The key to grasping the interrelation of the commonality and (entrepreneurial) efforts of others requirements lies in the origin of the test, and these requirements' *original* relation to one another.

In its brief to the court in the *Howey* case, the SEC argued for the application of a test very similar to the one that was eventually formulated by the court. However, crucially, the SEC did not submit that commonality was an out-and-out requirement for classification as a security. Rather, it argued that if an arrangement *does* evidence "commonality", then the efforts need *not* be tendered *solely* by the promoter or third party, and if the arrangement *does not* evince commonality then the profits would have to arise *solely* from these "managerial" efforts. Yet the court, seemingly having accepted the SEC's submissions regarding the test, omitted this qualification from its final pronouncement. Thus, at worst, the court mis-formulated and consequently misapplied a test it had appeared to accept. The end-result is that the commonality requirement became a fixed feature of the inquiry,

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122 *SEC v Koscot Interplanetary, Inc.* F.2d 473 (5th Cir. 1974) 478.

123 Gordon (2011) *Ohio State LJ* 61.

124 Gordon (2011) *Ohio State LJ* 61. See also Schneider (1981) *Rev. Sec. Reg*. 984, § B; Schneider (1991) *Rev. Sec. & Comm. Reg*. 14; McGinty (1993) *Wis. L. Rev.* 1083-1084; and Steinberg & Kaulbach (1985) *Vand. L. Rev.* 519-521.

instead of acting as a subsidiary determinative factor in the kind of "effort" required.[125] This explains (and justifies) the courts' subsequent efforts to attenuate the import of the term "solely".

Also, even before the *Howey* judgment, the SEC itself had already:[126]

> "modulated its investment contract test into its definitive form: where purchasers participate in a common enterprise, reliance need only be predominantly, not solely, on the efforts of others. Where they purchase tailor-made profit-making arrangements, they must rely solely on the efforts of others."

This, it is submitted, is the more theoretically cogent approach to the interpretation of "investment contract" in the United States. Seen in conjunction with "[predominantly] from the efforts of the promoter or a third party", the above reveals a key insight into the securities concept as a, primarily regulatory, signifier of a specific type of financial instrument. It shows that the more managerial control an investor's legal interest bestows, the less that investor is in need of regulatory intervention and protection. As a result, it is less important to classify the legal interest in question as a security, thereby subjecting it to corrective legal intervention. This appears to point, at least in US jurisprudence, to a materiality threshold ("solely" interpreted as "predominantly") determining whether regulation, facilitated by classification, is necessary.

In that light what remains to be discussed, in completing a discussion of *passivity*, is the modern meaning of enterprise. The ambit of the term has undergone a significant and continuous evolution as the broader financial context has changed dramatically over the past century.

To understand it, one must consider the nature and role of securities in the current and historic context. Securities function, in essence, as a means by which capital may be transferred from capital *holders* (those wealthy enough to have disposable, investable capital) to capital *users* (those whose commercial or public undertakings required such capital). Yet, over time, the nature of these capital users has changed significantly.

As shown in Chapter 2, securities were initially an instrument enabling government or state project-financing. This led to securities' use in parastatal commercial finance, which in turn acclimatised investors to private corporate finance in capital-intensive industries. These typically large projects are the kind of enterprises that represented traditional capital users.[127] However, as the financial marketplace became increasingly more sophisticated, new players (such as collective investment schemes, hedge funds and securitised debt securities schemes) emerged. Typically, these players

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[125] McGinty (1993) *Wis. L. Rev.* 1049.

[126] McGinty (1993) *Wis. L. Rev.* 1047-1050, who makes a convincing case for this interpretation of the *Howey* ratio.

[127] See Chapter 2, § 2 1.

defy categorisation as entrepreneurs in the traditional sense. Yet their efforts can still be described as “managerial”.

The final contemporary development is that securities have become an integral part of a complex finance and investment system that has become increasingly self-perpetuating. Modern securities markets have, in part, transcended their original function of financing capital-intensive endeavours *exogenous* to that system and became increasingly important to activities *endogenous* to the financial system. First there is the use of securities as real security for further lending. Second, and likely the most illuminating example of this development, is a new and totally different function fulfilled by securities – the repackaging of existing financial interests or even securities into new asset-backed securities. This occurs for a number of purposes, not always strictly related to the financing of managerial ambitions.[128]

Thus, any activity which involves the creation of securities in order to: (1) obtain capital, (2) leverage existing capital, or (3) convert a pre-existing cash-flow stream (e.g. receivables, most notably asset-backed debt instalments such as mortgage payments) into capital must be viewed as an “enterprise” in this context.

From this, it is clear that any enterprise within the context of securities markets still centres around the transfer of capital from *holders* to *users*. It follows that securities have not truly transcended their investment-functionality. Yet, it would appear that a *security* may entail something more than a mere exchange of capital for economic return.

If the original relationship between the requirements of commonality and “solely from the efforts of the promoter or third party” is historically correctly understood, and this is seen against the wide modern ambit of “enterprise”, the following emerges. Securities, by nature, involve not only the transfer of capital, but also the transfer of *control of capital* from holders to users, for the purpose of a particular enterprise. From the perspective of the capital user, this decreases the economic transaction costs of raising and utilising capital. From the perspective of the investor, it means: (1) not having to expend personal and direct effort in generating returns on that capital, and (2) the prospect of better returns arising from the knowledge and skill of third-party capital users as applied to a specific enterprise.

This means that over and above the basic trade-off inherent in all investment (capital put at risk for return), investment in securities entails a second trade-off – control of capital for effort and expertise. However, this second trade-off involves a unique set of risks for the investor. First, handing over

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[128] J Benjamin *Interests in Securities: A Proprietary Law Analysis of the International Securities Markets* (2000) 5 at § 1.07, 6 at § 1.09 & 251-299 (Chapters 11 & 12 – “Repackaged Products”).

control over capital increases agency risk (specifically the risk of moral hazard) and thereby also increases monitoring costs. Second, an absence of direct control over the managerial efforts expended to generate returns gives an investor far less scope to intervene in order to mitigate potential mismanagement. Third, an investor may not have requisite knowledge to evaluate accurately whether those in control of the capital are indeed skilled or honest, nor whether any representations made about the potential success of the enterprise are reasonable and accurate. It is this risk-premium that often drives the need to classify (and thus regulate) a particular legal interest as a security.

The first *indicium* stemming from the above is *control passivity*. It is wholly uncontentious that government-issued securities can confer no control over the state or any aspect thereof. However, this *indicium* becomes less clear cut when dealing with interests created in the private, commercial sphere. Here an investor's capital is solicited for the pursuit of a specific purpose: a commercial enterprise. Control of the enterprise, in turn, is (at least as a point of departure) synonymous with control over its capital. It follows that the core issue, if a legal interest does confer upon an investor a measure of control over the enterprise, is the degree and nature of that control. If the measure of control is sufficiently material, the risks outlined above will not be as acute. This may, depending on the teleology underpinning the legal issue or dispute at hand, militate against classification as a security.

To deal with this variability, it is useful to outline a spectrum of control. At the one end of this spectrum lies full and direct managerial control. This is the type of control typically held by a managing director or executive director – i.e. full or partial control over the "business and affairs" of the enterprise.[129]

Although classification is context specific, shares are almost universally considered securities. It is further uncontentious to assert that the *majority* of a body of voting securities-holders within a company context is able to exercise a certain kind of control over that enterprise – control over the directors. However, the evaluation is performed on the particular legal interest in question. On that basis the voting rights attached to single share or debenture are not sufficient to weigh in favour of not classifying these instruments as securities.

Here the definition of control used in the Companies Act[130] is quite useful. This test seems to provide a substantive guideline as to what this type of control constitutes: "the ability to materially influence

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129 See s 66(1) of the Companies Act 71 of 2008.

130 Companies Act 71 of 2008, s 2(2)(d) [own emphasis]. Another, similar but not identical, test for control is found in s 12 of the Competition Act 89 of 1998.

the *policy* of the enterprise". Delport describes the control as dependent on the context in question. Here "material" pertains to the scope of the power held, and the power itself is explained as:[131]

> "[the] power to do something (which may be the positive power to determine an outcome or the negative power to prevent an outcome). However, if the power applies only to one or two matters, depending on the nature of those matters, it may not be sufficiently extensive to meet the threshold of materiality. The range of influence need not be as extensive as that exercised directly by shareholders through the general meeting or indirectly through the board by the person with the power to appoint the directors but it must, as in both those cases, be reasonably extensive since otherwise it will not be comparable to the influence."

This provides the following insight into the kind of control at issue: *individual* or *direct* control over the enterprise entails the ability to determine how capital, raised by means of securities, is utilised in furtherance of that enterprise. Securities typically place this type of control beyond the purview of the single investor in her capacity as investor. But, again, the inquiry is centred on the legal interest in question, not the interest-holder in question.

Therefore, in terms of a given constitutive financial arrangement, if the performance-creditor is excluded from having any direct control over decisions regarding the application, by the performance-creditor, of her economic contribution, the product of that arrangement is more likely to be classifiable as a security. Conversely, by way of example, a 70% members' interest in a close corporation is less likely to be classified as a security in a situation where an Act or rule has not explicitly identified "members' interest" as a security for its application.

In summary, it is typical of securities that the overall patrimonial value of the performance or related set of performances should not only be materially contingent on the strength or weakness of enterprise-related decisions, but the performance-creditor should be excluded from having direct control over the enterprise and decisions. This accounts for *indicium* "1 4" above – i.e. control passivity.

A second dimension to the passivity outlined above is that the underlying interest of a security typically contains little to no duties corresponding to rights held by the overall performance-debtor. Put more simply, if a legal interest holder – referred to here as the performance-*creditor* – does not incur duties by virtue of her holdership, it is more likely that the underlying interest is classifiable as a security.

The legal interest underlying "true" securities typically does not contain any duties – the fixed economic contribution serving as counter-value for the security is typically paid *beforehand* in terms of the acquiring agreement, and is remote from the legal interest underlying the security itself. This

131 Delport et al *Henochsberg* § 2, 30(3)-(4).

is because the constitutive source of rights that make up the beneficial interest of a security typically does not contemplate any counter-performance and is therefore incomplete as a source of binding obligations. That source fulfils the function of a standard-form offer, or offer to make an offer (depending on the factual matrix at hand and whether other material terms, specifically the price of the security, are certain or ascertainable yet).[132] As seen in Chapter 4,[133] the creation of securities typically *externalises* counter-performance to a separate, secondary source – the agreement that serves as the *causa* for the creation and bestowal of those rights in exchange for value. This can take the form of an allotment or subscription contract, consensus reached by auction, or a simple agreement to transfer.

The context of derivatives serves to illustrate the point even further. Most financial instruments are transactional in nature – accordingly, most derivatives are bilateral. Swaps are the most obvious example, as each swap typically contains asymmetrical sets of rights and duties, each tailored to the needs of the two holding counter-parties.[134] In a credit default swap with fixed and variable legs respectively, holdership of the former entails making fixed payments in exchange for receiving more value than the sum of those payments if an uncertain future condition occurs. The holder of the latter is obligated, should the specified event occur, to provide that value but receives the fixed payments on an ongoing basis in return (betting the event will not occur or the condition will not be met during the term of the swap). What matters here is that the legal interests held on both sides of the arrangement contain both rights and duties.

However, an option is *not* a reciprocal derivative. An option displays the kind of duty passivity that is to be expected in instruments uncontentiously classifiable as securities. The (generic) option-holder has the right to enforce a specific purchase price at a future date. There is typically no *duty* to exercise the option. Furthermore, the ostensible duties of paying for the option and paying the agreed-upon price, if exercised, flow from the overall constitutive financial arrangement within which the option was created.

Thus, this *indicium* increases the likelihood that an option should be classifiable as a security, but conversely decreases that likelihood in the case of swaps.

It must be reiterated, lastly, that *consequential* rights and duties are excluded from the typological inquiry to avoid circularity of reasoning. Securities may very well entail duties, such as the duty of

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132 See SWJ Van der Merwe, LF Van Huyssteen, MFB Reinecke & GF Lubbe *Contract: General Principles* 4 ed (2012) 47-50 & n 14 for auction sales.

133 See Chapter 4, § 4 2.

134 See Malan & Faul (1992) *TSAR* 394, specifically § 1 – § 4.

disclosure in s 56 of the Companies Act of 2008, but these are duties that arise consequentially rather than consensually. This accounts for *indicium* "2" above.

6 3 3 2 Contextual indicia

The second leg of the comparison is a context test, which considers the typical features of securities that do not relate strictly to the substantive properties of the underlying interest. Thus the focus is on the attributes of: (1) the held legal interest as a whole, (2) the correlative constitutive arrangement between legal interest holder or holders and counter-party or -parties, and (3) the context within which these elements function. They can briefly be summarised (their numbering following on the preceding *indicia*) as follows.

3 the legal interest derives a material part of its patrimonial value indirectly, based on the degree to which the overall enterprise of the performance-debtor is successful ["enterprise-derived value"];

4 the constitutive arrangement evidences the potential for asymmetrical multilateral relations: the counter-parties stand in a relationship of one performance-debtor to a potential multitude of legal interest holders ["multiplicity"];

5 the constitutive arrangement, alone or in conjunction with the operation of law, contemplates the (once-off or repeatable) creation and allocation of more than one such legal interest in series, so that each interest is economically fungible in relation to others of the same type and issue ["quasi-fungibility"];

6 if the legal interest consists of more than one right, or right and other competency, the constitutive arrangement, alone or in conjunction with the operation of law, facilitates the treatment of the totality of the underlying interest as a single patrimonial object, over which rights can be established, but out of which rights cannot ordinarily be ceded ["bundling"];

7 the constitutive arrangement, alone or in conjunction with the operation of law, contemplates that the performance, or most of the performances, of which the legal interest is comprised must be tendered by the performance-debtor exclusively to:

7 1 one legal subject whose identity is evidenced by entry on a register (irrespective of its form or title) as well as, prima facie, evidenced by the issue of a certificate (irrespective of its form or title),

7 2 one legal subject whose identity is evidenced by entry in an electronic register maintained by a licenced central securities depository or participant such that it may, in accordance with the applicable general law, be held in dematerialised form, or

7 3 a combination of the above

irrespective of whether the patrimonial or economic-end benefits of the performance or related set of performances of that object vests in the estate of another, different legal subject ["exclusivity of execution"]; and

8 the constitutive arrangement or held legal interest otherwise presents in a context which indicates that the latter is a security ["context"].

The reasoning behind each of these factors will be analysed below, although these factors are admittedly less technical than those of the previous section.

Enterprise-derived value

In the analysis of the *Howey* test above, it was shown that one of the distinctive characteristics of securities is the enablement of a trade-off between control of capital and managerial skills and expertise. Another consequence of this observation is that securities derive their value from the application of that skill and experience in the enterprise towards which the capital is contributed. It follows that a strong indicator that a held legal interest is a security is whether the *value of the interest* is in fact to some extent a *proxy for the success of the enterprise*. This is what is meant by "enterprise-derived value" as the first contextual *indicium.*

In more detail, it requires that the *patrimonial value* of the *claim* to a performance, or set of related performances (around which the legal interest is structured), bear a strong nexus to the *overall* success or failure of the underlying purpose towards which the capital is being contributed.

Typically, that purpose should further be some form of enterprise (typically entrepreneurial, managerial or financial) on the part of the issuer and performance-debtor. This does not mean that the effect of market forces (i.e. the putative efforts of the surrounding economic environment) or the actual efforts of the investor are immaterial or "inimical"[135] to classification as a security merely because they impact upon that patrimonial value. However, for classification as a security, the degree of overall success or failure of the enterprise (as purpose for which the capital was allocated) at any moment in time should materially affect, and indeed determine, the value of the claim or set of claims bestowed on the legal interest holder.

Consider the following concrete illustrations. The patrimonial value of the beneficial interest in a share is typically based on the estimated discounted future: (1) cash flow from dividend income, and (2) current value of payment of a sum proportionate to the proprietary interest in the company and

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135 As per *SEC v Koscot Interplanetary, Inc.* F.2d 473 (5th Cir. 1974).

its assets (capital, or the "incidence of risk"[136] of the enterprise). Both of these are chiefly derived from metrics such as the discounted future cash flow of the company as a whole, or a multiple of its "EBITDA" (earnings before interest, taxes, depreciation and amortisation). Or, more simply: a determination of the present value of the enterprise.

The patrimonial value of the beneficial interest in a debt security, such as a bond, is typically contingent on the discounted future value of the coupon payments (principal sum lent and interest, however structured), factoring in two other variables. First is an estimation of the likelihood that the debtor will default on those obligations (this is central to the valuation and differentiation of different debt securities), which is *also* a function of the future discounted cash flow of the overall enterprise (in this instance not limited only to companies). Second is an evaluation of the prevalent macro-economic environment and specifically its interest rates, which are crucial in evaluating the market value of the debt security relative to other interest-bearing investment instruments.

Thus the principle is most clear in the case of shares, as the *present degree of overall success or failure* – i.e. the state – of the enterprise directly determines the present value of a claim to potential future performance in the form of payment of dividends and the share of the residual assets of the enterprise after winding up. More indirectly, the state of the enterprise is also central to determining the prospects of the enterprise and will thus materially affect the projected value of future performance in the form of payment of dividends.

In the case of debt securities the state of the enterprise determines the creditworthiness of that enterprise, which in turn determines default risk. As seen above, creditworthiness and default risk are fundamental determinants of the value of any claim to performance in the form of coupon payments.

Thus a performance or a set of performances that typifies a security (which is typically designed to be tendered at one or more *future* dates)[137] derives, at the very least, a material part of its value from the state of the enterprise for which the capital was provided.

Multiplicity

Multiplicity relates to the types of relationships typically created by securities and is also fundamental to understanding the "security instrument" component of registered securities. It is typical of

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136 See *Standard Bank of South Africa Ltd. and Another v Ocean Commodities Inc. and Others,* 1983 (1) SA 276 (A) 288, and F Oditah "Takeovers, share exchanges and the meaning of loss" (1996) 112 *Law Quarterly Review* 424 426-427.

137 See also Chapter 4, § 4 1 1.

constitutive arrangements that give rise to legal interests which *are* considered securities to have asymmetrically multilateral effect. This rests on two characteristics.

First, the constitutive arrangement between the legal interest holder and the counter-party should provide for, or merely be capable of creating, more than one identical or materially similar legal interest (irrespective of whom these interests are bestowed upon over and above the legal interest holder in question) operative against a counter-party.

Second, what multiplicity further requires is that such an arrangement makes provision for one performance-debtor counter-party, but a multiplicity of (actual or potential) legal interest holders whose interests are identical (or materially similar) to that of the legal interest holder in question.

Together, this means the arrangement envisages a many-to-one relationship structure – i.e. is asymmetrically multilateral. It is not inconceivable that a single security may be issued to a single acquirer, as pointed out by Delport.[138] Nonetheless, as long as the constitutive arrangement evidences the potential to apply in this asymmetrically multilateral way, it would certainly influence the probability that the constitutive arrangement bestows something classifiable as a security.

Quasi-fungibility

Something is fungible if its characteristics cause it to form part of a broader *genus* of identical objects, such that one such object is the economic equivalent of another. Thus fungible things are fully replaceable by, or interchangeable with, any other object which is member of that *genus*.[139] Fungibility is typically encountered in the law of things and the notion of fungible obligations or immaterial property rights is an understandably unintuitive one, though perfectly conceivable.

This quality has a number of important consequences, most notably in the law of sale. For example, a generic thing as the object of a sale need not be in existence at the time of contract conclusion, it affects the incidence and passing of risk between the time of contracting and the time of delivery, and affects the remedies available to the contracting parties.[140] Here the parties' intention is

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138 Delport *Henochsberg* § 43, 184(1), citing the English case of *Knightsbridge Estates Trust Ltd v Byrne* 1940 AC 613 (HL) [1940] 2 All ER 401 as an example of the (legitimate) issue of a single debenture.

139 See Van der Merwe *Sakereg* (1989) 47-48, PJ Badenhorst, J Pienaar, H Mostert & M Van Rooyen *Silberberg & Schoeman's The Law of Property* 4 ed (2003) 46.

140 See for instance G Bradfield & K Lehmann *Principles of the Law of Sale & Lease* 3 ed (2013) 27, 69, and 76 & 79, respectively; or CFR Van den Bergh "Perfecta emptione periculum est emptoris: why all the fuss?" (2008) *Tydskrif vir die Suid-Afrikaanse Reg* 623.

important, as a thing may be fungible by nature or fungible by agreement (a good example of the latter is an agreement to buy "a car", making the object of the sale any car).[141]

Shares or debt instruments of the same class are typically, but not always, issued in series, and with serial numbering. Thus, by nature, each specific such security is identifiable and individualised. However, each security *asset* in such a class is substantively identical. All "class B shares of company X" are *patrimonial equivalents*, though their instruments may be distinguishable by serial numbering (if applicable). It follows that any shares or debt securities of the same class must be designated as at least *quasi*-fungible, or if not issued with unique identifying numbers then *wholly* fungible. This has already been covered in some detail in the context of "collective deposit" in Chapter 3[142] and more importantly in § 5 1 3 of Chapter 5.

In the previous two chapters much was made of the enhanced proprietary character of securities, specifically as objects of *trade*.[143] Aside from traditional securities such as equities and bonds, large-scale trading platforms have also developed around derivatives such as futures and swaps[144] as these instruments became similarly tradeable:[145]

> "A secondary market for swaps developed, due not only to intermediaries refining their swap financing capabilities, but also *to swap contracts themselves acquiring those characteristics necessary for their being acceptable in trade.* Henderson explains the process as follows:
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> > 'Trading indicia were simulated by making, terminating, and assigning swaps and quoting swap prices, coupled with using sophisticated portfolio hedging activities. Many swap institutions began to view themselves as "dealers" in swaps, rather than extenders of corporate financial services or credit.'…"

However, (*quasi*-)fungibility is not a prerequisite for trading on a financial marketplace. Also, due to the inherent nature of derivatives, individual derivative instruments are not always identical to, or interchangeable with, others, nor are they always issued in series or classes.

Once again, here teleology plays an important role in the classificatory process. For example: a series of identical grain futures are issued by a certain financial institution and they are purchased privately by a number of individual farmers seeking to hedge their risks. The held legal interest of each farmer is fungible in relation to that of the others. Depending on the teleological import of the

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141 See Badenhorst et al *Property* 46.

142 In § 3 2 1; as well as § 3 2 2.

143 See § 4 3 2.

144 See Chapter 2, § 2 3 2.

145 Malan & Faul (1992) *TSAR* 397 – see also n 32-33 therein.

legal issue requiring a classificatory determination, this *indicium* may carry more or less weight in the overall (i.e. holistic) classificatory impression – i.e. the *Gesamtbild.*.

Bundling

Consider the following counter-factual scenario. There are a great many kinds of contracts concluded on a daily basis. Some of these contracts (given the South African law of contract, rather than contracts) are of great complexity and scope. Complex contracts typically contain a large number of unilateral, bilateral, multilateral or reciprocal rights and duties. Many of these contracts are financial in nature, and some, such as the *en commandite* partnership, closely resemble the kind of constitutive arrangements that typify securities. That alone does not make the held legal interest of one of the parties to such a contract something more that the sum of its parts. The integrated whole of a held complex set of rights and duties cannot always correctly be characterised as a bundle or complex of rights in the same sense as has been said of, for instance, shares.

Conversely, in many respects securities are seen as the composite sum of their respective underlying parts. In commercial reality a security is perceived and treated as a single *asset*. Commercial law as a living, doctrinally flexible,[146] branch of law must take cognisance of this and reflect it. In the case of registered securities, this is well illustrated in the function of the security-instrument as it has developed over time. The instrument increases the economic efficiency of a complex and multi-party borrowing arrangement by creating a single person *to perform towards* (the instrument-holder), irrespective of the identity of the person entitled to the beneficial results of such performance. A corollary of this is that, no matter what the underlying interest consists of, benefits will always flow through that instrument – in other words, the instrument has a strongly cohesive effect on the various elements of the underlying interest.

Personal rights can never *be* corporeal. Even in the case of negotiable instruments the rights are merely “embodied in” the document, rather than having merged with the document.[147] Yet on a spectrum between oral agreements and negotiable instruments, holdership of personal rights can be associated with varying degrees of corporeality. Before the advent of dematerialisation, holdership of registered securities specifically was closely tied to paper – not so closely that non-bearer securities were considered negotiable instruments, but closely enough that negotiability by estoppel has been applied.[148]

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146 See Chapter 4, § 4 1.

147 Cowen & Gering *Negotiable Instruments* 26-27 & 52-55; and *Randfontein Estates Gold Mining Co Ltd v Custodian of Enemy Property* 1923 AD 576 582 specifically in the context of (negotiable) bearer debentures.

148 See, again, Chapter 4, § 4 3 2.

It is, therefore, unsurprising that in commercial reality and common parlance the phrases "ownership", "sale" or "purchase" of securities is often found. Judicial recognition has also been given to the usefulness (although not necessarily appropriateness) of this type of terminology.[149] Furthermore, s 91 of the previous Companies Act[150] and s 35 of the current Act both purport that shares are "movable property" (and it has been argued that the same ought to apply to other company securities as per s 43 of the Act). Designation as property is doctrinally somewhat problematic,[151] but it has practical and analytical usefulness. Examples of this are the application of a vindicatory remedy styled as a *quasi-rei vindicatio*[152] as well as (more contentiously) the availability of the *mandement van spolie* on the basis of so-called *quasi*-posession.[153] This has, however, been covered in Chapter 4, and will be dealt with further in Part 2.[154]

It would seem that the positive law, for a number of purposes, treats securities as one patrimonial object irrespective of whether it comprises of more than one right. The fact that certain interests in the underlying interest of that security may be granted reinforces this observation. For example, a share primarily consists of the rights to dividend income and the payment of a sum equivalent to the holder's share of the residual assets of the company. Yet it may very well be that the individual right to dividend income, for instance, cannot be out-and-out ceded separately to a third party – instead, it must be made the subject of a *real right* such as *usufruct*.

Bearer securities take this a step further by utilising the concept of negotiability to tie the underlying rights together, not only *through*, but also *to* a specific piece of paper. How this may be otherwise facilitated need not be dealt with here; however, an example may be a conditional (and instrinsic) *pactum de non cedendo* prohibiting out-and-out cession of one element of the underlying interest without the rest.

Exclusivity of Execution

The work in Chapter 4 regarding the nature of registered securities should make the import of this *indicium* more than apparent. Suffice it to say here only that a held legal interest would undoubtedly

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149 For example *Oakland Nominees (Pty) Ltd. V Gelria Mining & Investment Co (Pty) Ltd* 1976 (1) SA 441 (A) 447H or *Standard Bank of South Africa Ltd & Another v Ocean Commodities Inc. & Others* 1983 (1) SA 276 (A) 288H-289D.

150 61 of 1973.

151 See Chapter 4, § 4 1; and AJ Van der Walt & PJ Sutherland "Dispossession of incorporeals or rights – is the mandament van spolie the appropriate remedy?" (2003) 15(1) *South African Mercantile Law Journal* 95 100.

152 *Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd.* 1976 (1) SA 441 (A).

153 See *Tigon Ltd v Bestyest Investments (Pty) Ltd* 2001 (4) SA 634 (N) 643A-B, but also the critique of Van der Walt & Sutherland (2003) *SA Merc LJ* 96.

154 Chapter 4, § 4 3 2.

be more readily classifiable as a security if it evidences, or seems to emulate, the effect of the security-instrument as found in registered securities.

Context

This particular *indicium* also needs very little explanation. It functions simply to allow the inquiry to make a better holistic determination by examining and analysing the broader context and any relevant other factors therein, *provided the rationale is clear and sound*, when classifying a held legal interest as a security.

In conclusion, from the analytic-systemic analysis conducted in this chapter and Chapters 4 and 5, a more theoretically sound and consistent framework for a general understanding of the legal nature of securities has been laid out. It is also a framework which is of great use when applied to the relatively unexplored context of debt securities in particular, and one which is able to provide a robust basis from which to analyse more specific debt-security oriented issues in the domestic law. This will be taken up in Part 2 of this work.

PART 2

APPLICATION TO CONTEMPORARY SECURITIES LAW

CHAPTER 7

7 What is a debt security?

Part 2 of this work aims to complete the examination of the legal nature of debt securities through the application of a *functional-policy approach* to issues related to (debt securities), arising from the law as currently stated. According to Cowen & Gering, the application of this approach to the law of negotiable instruments:[1]

> "laid emphasis on the purpose or objectives of the merchants during the great formative periods of the relevant law, and especially the various considerations of policy which, from time to time, influence legal systems in adopting certain solutions rather than others. Those who adopt this approach focus attention particularly on the fact that negotiable instruments were, and are, designed to serve as a substitute for money; and they show how many of the operative rules (including what might superficially appear to be 'rule of thumb' requirements of form) are means of achieving this objective with ease and safety. They emphasise, too, the fundamental policy choice, and the important consequences of the choice, which legal systems have to make in the allocation of risks between the interests, on the one hand, of persons who sign negotiable instruments, and, on the other hand, the protection of a market in which these instruments are dealt with by persons acquiring them in good faith and for value."

This approach, with the necessary modification, is strikingly appropriate to an analysis of the various current legal problems and uncertainties surrounding securities. Its application here uses, as basis, the historical and theoretical analyses of the preceding chapters.

Use of this final element of the broader chosen methodology requires an understanding of the "purpose or objectives" of *participants to the financial marketplac*e in the adoption of securities as a solution to certain commercial and economic problems. This facilitates a more practical analysis of the law's "operative rules as a means of achieving [these objectives]", because it occurs at the intersection of securities' economic objectives and the policy-matrix underlying the legal rules themselves. When applied in light of the theoretical development in Chapters 4 and 5, this methodology brings about an improved application of the existing law to securities, allowing for improved outcomes both currently *and* from a forward-looking perspective.

To some extent the underlying functional-policy dynamics of securities have been considered and discussed in previous chapters, but only in so far as it was *theoretically* necessary. What this Part aims to do is concretise these outcomes through analysis that articulates, much more specifically,

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[1] DV Cowen & L Gering *The Law of Negotiable Instruments in South Africa: Volume One* 5 ed (1985) 9-10.

the effect of securities' unique legal character on selected elements in the larger body of *regsproblematiek* that surrounds debt securities currently.

What follows, however, does not attempt to deal with all, or even most, of the issues which may arise under the broader stated theme. The number of problems which could potentially be dealt with are simply too numerous for a thorough analysis of each. Nonetheless a decision to favour depth over breadth has been taken, and therefore this chapter attempts a more in-depth discussion of a select number of problems. It is hoped that this treatment illustrates both the viability of the approach developed in this work as well as the need for further study and application of its concepts.

However, before any of this is covered, what is a debt security? From the outcomes of Part 1, a far more functional (and legally modern) general definition can be formulated:

> *Where an obligationary borrowing arrangement leads to a held creditor's interest which is typologically classifiable as a "security", that legal interest is a debt security (and shall thereby include all applicable 'consequential'* ex lege *elements accruing to that interest).*

Thus, being a debt security, it will be subjected to all aspects of the positive law which govern debt securities. If such a debt security further evinces the properties of a *registered* security it can be subjected to the principles outlined in Chapters 4 and 5. These securities will be the focus of all remaining chapters, as has been the case for all except the preceding chapter. Accordingly, unless the context indicates otherwise, the analysis will refer to registered securities simply as "securities".

It is also important to note that when dealing with securities in the context of the present and past Companies Acts, authoritative sources even today retain a decidedly share-centric approach, and much of what is drawn from below is stated primarily in the context of shares. In light of the outcomes of Chapter 3 this is not surprising. In contrast, however, the broader scheme of the Companies Act 71 of 2008 does away with most legislative differences between shares and company debt instruments, with most of the relevant provisions referring to *securities*. The outcomes of Chapters 4 and 5, again, show that there are few material structural differences between shares and contractual securities, though the content of their underlying interest may differ vastly. Thus, as a point of departure, any reference to shares will assume applicability to debt securities as well, although every effort has been made to deal explicitly with instances where this assumption requires challenge.

CHAPTER 8

8 The transfer of debt securities

The transfer of securities can be described in general terms as *the voluntary conveyance of the rights of a security-holder, as contained in a (pre-existing)*[2] *security, from a person who wishes to cease to be, to a person who wishes to become, a holder of that security.*[3] It is to be distinguished from the "transmission" of securities, which is dealt with briefly in the final section of this chapter.

The definition above seems to indicate a transfer of the beneficial interest to the transferee along with replacement of the transferor by the transferee on the securities register (and, if certificated, the issue of a new certificate in the latter's name). However, it can also be given a more restricted meaning as transfer only of the beneficial interest, without a change to the securities register. It may

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2 See *Rosenberg v Nuco Chrome Bophuthatswana (Pty) Ltd* [2010] JOL 25758 (NWM).

3 Adapted from S Blackman, RD Jooste, GK Everingham, JL Yeats, FHI Cassim & R de la Harpe *Commentary on the Companies Act: Volume 1* (RS 6 2009) 5-354. The original text reads:

> "the voluntary conveyance of the rights and obligations of a member, as represented in a share in the company, from a person who wishes to cease to be, to a person who wished to become, a member in right of that share."

See similarly JL Yeats, R de la Harpe, R Jooste, H Stoop, R Cassim, J Seligmann, L Kent, R Bradstreet, RC Williams, MF Cassim, E Swanepoel, FHI Cassim & K Jarvis (2018) *Commentary on the Companies Act of 2008* 2-797.

also refer only to a replacement of one registered holder with another, although historically this has typically been qualified as *registered* transfer.[4]

This ambiguity is no longer necessary. The work of Chapters 4 and 5 reconceptualise securities as comprised of two interdependent legal objects – the security asset and instrument – which can be separately held as objects. The work of § 4 3 2 of Chapter 4 also replaces the problematic terms "ownership" and "title" with (lawful) security-, asset-, or instrument-holdership. Using this more precise terminology, the exact import of any transfer is clarified through reference to transfer *of:* security-, asset-, instrument-, or even limited real interest-holdership, as the case may be.

Turning now to debt securities specifically, these securities can be issued by any artificial legal person.[5] Any account of the transfer of debt securities should take cognisance of consequential legal differences, where they exist, in the transfer of securities of various kinds of issuers. This has been integrated into the analysis of each section and highlighted where applicable.

The transfer of debt securities is not, generally, a particularly contentious aspect of the law at present. Nonetheless, a stated goal of this work is also to *clarify* the law through the lens of Chapters 4 and 5 in a manner that leaves unchanged as much of the current legal framework as possible.[6] With that in mind, five issues have been identified which do require some attention here: the manner in which (1) certificated, and (2) uncertificated securities are transferred; (3) the manner in which transferability of (both company and other) debt securities can be restricted; (4) how transmission of securities should be understood; and (5) the matter of the transfer of limited real interests in securities.

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4 In the context of company securities, as per Yeats et al *Commentary 2008* 2-513:

> "In its full and technical sense, a 'transfer' of securities is not a single act but consists of a series of steps, certain of which may be contemporaneous. 278 It involves: (a) an agreement to transfer; (b) the transfer of the rights attaching to the securities from the transferor to the transferee (which takes place by way of cession of the beneficial ownership); and (c) the registration of the transferee as a securities holder in respect of the securities (e.g. a shareholder as the holder of a share). The term 'transfer' in relation to securities (particularly shares) is, however, frequently given a more restricted meaning with reference to only one of the above acts, for example, to just a transfer of registered title."

Similarly, see: Blackman et al *Commentary* 5-354 & 5-355 (see also n 1 on 5-355); A Borrowdale "Shares and the elusive meaning of 'transfer'" (1985) 102 *South African Law Journal* 277; and Delport et al *Henochsberg on the Companies Act 71 of 2008* (SI 11 – 2015) § 51, 211. It must be noted that Delport evinces a different opinion on the meaning of 'transfer' under the 2008 Companies Act, but this will be dealt with in the next section.

There is no similar relevant authority for debt securities issued by other issuers, but the principles seem readily applicable to all *transferable* securities on the basis of registered transfer being contractually built into these securities – see Chapter 3, § 3 1; and Chapter 4, § 4 1 2; § 4 1 3; and § 4 2.

5 See also Chapter 5, § 5 3 2.

6 See Chapter 1, § 1 2 – "a great deal of care was taken to ensure that the theoretical outcomes of this work should not be at odds with practice or commercial reality. It is hoped that the foundations have been improved with little to no damage to the structure that has been erected upon it."

8 1 The transfer of certificated securities

The transfer of certificated securities (i.e. transfer of *security*-holdership) is traditionally said to consist of a minimum of three steps. The first is the coming into existence of a reason for the transfer (typically the conclusion of a contract for the transfer of the security), the second is a cession of the underlying beneficial interest, and last is registered transfer.[7] There is also the requirement, for company securities, of delivery of a "proper instrument of transfer", though whether this is a *prerequisite for transfer* is discussed later in this chapter.[8]

In light of the outcomes of Chapter 4 and the treatment of "transfer" above, it is more accurate to see these requirements as: (1) the conclusion of a juristic act which serves as *causa* for the transfer; (2) transfer of asset-holdership; and (3) transfer of instrument-holdership.

8 1 1 Causa

The *causa* for the transfer of security-holdership, and similarly mere asset-holdership, is typically a contract. In most cases it takes the form of sale, bequest, or donation, but it may also arise from other obligationary sources. One such example is a court order – in these cases transfer appears mandatory, but it remains a legally voluntary transfer (i.e. a volitionary legal act) in that it has not occurred automatically by operation of law. A transfer of certificated securities may further be part of a larger arrangement or may occur by virtue of a single transaction of transfer.

In contractual arrangements for the transfer of certificated securities, the ordinary rules of contract law apply.[9] A specific set of *naturalia* (or perhaps merely tacit terms), emerging primarily from shares-based jurisprudence, has emerged for this kind of sale, specifying that:[10]

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7 See also Yeats et al *Commentary 2008* 2-799; Blackman et al *Commentary* § 133 generally, 5-354 & authorities in n 1, and 5-355 with case law authorities cited in n 5; Delport et al *Henochsberg 2008* § 5, 211; and FHI Cassim (ed) et al *Contemporary Company Law* (2012) 241-243.

8 See § 8 1 3.

9 However, the Companies Act 71 of 2008 leads to some notable modifications to those ordinary rules, including cases of public offers of company securities (Chapter 4 of the Act), certain instances related to fundamental transactions, takeovers and offers (Chapter 5 of the Act), business rescue and compromise (Chapter 6 of the Act), as well as the effect of restrictions on the transferability of securities (see s 8) and the operation of certain remedies (as per Chapter 7 of the Act).

In this regard the general discussion in Yeats et al *Commentary 2008* at 2-817 – 824 is of great usefulness.

10 Blackman et al *Commentary* 5-357.

From these *naturalia* the broader publicity function of the security certificate, and rooted in the norm of *legal certainty* as the policy basis from which its publicity function emerges, is clear.

> "(1) the transferor (the seller) will cede to the transferee (the purchaser) the rights sold; (2) the transferee will pay the price and the transferor will hand over to him a genuine instrument of transfer and…a certificate; (3) the certificate carries the rights and interest which it purports to convey; (4) there is no undertaking by the transferor that the transferee will be registered [as instrument-holder]…; (5) the transferor will do nothing to prevent the transferee from having the transfer registered or to delay that event; (6) the transferee will indemnify the transferor against any liability which may arise in respect of the [security] subsequent to transfer."

The transfer itself, in accordance with the South African law's abstract approach to property and its corresponding effect on cession,[11] does not automatically occur by virtue of conclusion of this causa. Yet this may occur through the parties' intention for it to be included, for example in a sale.[12] In these instances, it is merely a case of two separate "conceptually and functionally distinct" juristic acts being concluded (and often embodied in a document) simultaneously.[13]

8 1 2 Cession of the security asset

Transfer of the beneficial interest in certificated securities occurs by cession, with no formal or substantive requirements other than the corresponding intentions of the cedent and cessionary.[14] In this sense it is quite correct to state that "[t]he distinct agreement effecting the cession of the rights to the securities is…governed by the common law with due reference to the memorandum of incorporation and the Act", or the applicable constitutive arrangement for non-company securities.[15] The work of Chapter 4 shows that, technically, it is a limited cession, but this has no practical effect on the legal position.

However, as is the case in the conclusion of all juristic acts, there are certain substantive prerequisites related to the "viability" of a cession, namely that:[16]

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11 See CG Van der Merwe *Sakereg* 2 ed (1989) 16-18; PJ Badenhorst, J Pienaar, H Mostert & M Van Rooyen *Silberberg en Schoeman's The Law of Property* 4 ed (2003) 82-83; and, importantly, SW Van der Merwe, LF Van Huyssteen, MFB Reinecke & GF Lubbe *Contract: General Principles* 4 ed (2012) 389-390 as well as GF Lubbe "Cession" in WA Joubert et al *Law of South Africa* Vol 3 (3 ed) 2013 § 135.

12 See *Botha v Fick* 1995 (2) SA 750 (A), *Watt v Sea Plant Products Ltd* 1999 (4) SA 443 (C) and Blackman *Commentary* 5-361 & n 5.

13 Van der Merwe et al *Contract* 389 & n 33.

14 See *Botha v Fick* 1995 (2) SA 750 (A); as well as Yeats et al *Commentary 2008* 2-833; Cassim et al *Company Law* 242; Blackman et al 5-360 and the great number of authorities cited in n 3 therein; and Delport *Henochsberg 2008* § 51, 211.

15 Yeats et al *Commentary 2008* 2-804.

16 Lubbe "Cession" in *LAWSA* § 157 ("Viability").

" (a) both the cedent and the cessionary exist;

(b) both the cedent and the cessionary possess contractual capacity;

(c) the cedent is the holder of a right; and

(d) that right is capable of being transferred."

This is a useful exposition of the implicit assumptions underlying any cession. The corresponding intentions which form the core of a cession have been rightly referred to as "mere consensus".[17] This should be distinguished from consensus in the contractual setting, and the contractual capacity in "(b)" above is simply a reference to the *kind of* capacity required to form the legally effective intention for the juristic act in question.

It should be clear from Chapter 4 that the term "right" above is too narrow for the securities context, in which it should instead be read as referring to the (still essentially obligationary, but composite) legal object in question. This is for three main reasons.

First, it is established that "[r]ights accessory to the subject matter of a cession and powers enjoyed by the cedent in respect of such a right will ordinarily pass to the cessionary without the need for a special cession thereof."[18] Support for this position is found in *Pizani v First Consolidated Holdings (Pty) Ltd* (rights operative against a surety),[19] as well as *Frankfurt v Rand Tea Rooms Ltd & Sheffield*[20] and *Nell v Barry*[21] (both dealing with the power to cancel a contract in the event of breach). What is being ceded in this context can, and most often is, comprised of both rights *and* other competencies.

Second, by virtue of the nature of securities, the security asset (i.e. the beneficial interest) does not contain any element of its rights and competencies' entitlement of determination (or *beskikkingsbevoegdheid*). This aspect of the underlying interest resides, for good reasons of practice and policy, in the security instrument. Holdership of the instrument is holdership of a separate legal object.[22] Therefore any limited cession having the beneficial interest as object, but which also purports to bestow the ability to execute the underlying interest of a security, must be void at least to the extent to which it purports to bestow that which cannot be bestowed. Holdership of the security

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17 Van der Merwe et al *Contract* 392 & 393-395.

18 Van der Merwe et al *Contract* 401 & n 131.

19 1979 (1) SA 534 (A) 541.

20 1924 WLD 253.

21 1958 (2) SA 687 (O).

22 See Chapter 4, § 4 1; § 4 1 3; and § 4 3.

asset does include the entitlement of execution and it is a well-established rule that one cannot transfer more than one holds.[23] The only manner in which to gain the incidents of execution is through transfer of the security instrument, which is dealt with further below.

Third, although a cession cannot be successful without *legal* viability, "factual…effectiveness is not a prerequisite for validity" of a cession.[24] A cession of the security asset cannot, on its own, enable the cessionary to *factually control* the object of that cession. As was established in § 4 3 2 2 of Chapter 4, effective factual control of a security, and of any subsidiary element of this security, is control over the instrument-holder. Control by an asset-holder can be achieved by obtaining instrument-holdership, but this is not necessary in order to establish the asset-holder's control over the content of the security asset. Upon effective cession of the security asset, the law will read an automatic, *sui generis*,[25] relationship of agency into the relationship between the cessionary as new asset-holder and the instrument-holder. This simultaneously extinguishes the agency that existed between the transferor as previous asset-holder and the instrument-holder.[26] Nonetheless, whether the transferee has gained effective factual control of the security asset's content does not in any way affect the validity of the cession of the security asset.

Thus an ordinary cession, without more, will cause the transfer of the totality of what is contained in the security asset. Although *debt* securities' underlying competencies may arise from a collection of sources,[27] the similar underlying structure of all securities requires no differentiated treatment. This position is confirmed in *Standard Bank v Ocean Commodities*,[28] and also supported by the fact that

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23 "*Nemo plus iuris ad alium transferre potest quam ipse habet*" – *D* 50 17 54.

24 So that, for example "a cession is not invalid because the cessionary is unable to locate either the debt or the debtor" – Lubbe "Cession" in *LAWSA* § 157, and cited therein: *Goode*, *Durrant & Murray* (*SA*) *Ltd v Glen & Wright* 1961 (4) SA 617 (C) 620; *Randbank Bpk v Morris* 1977 (2) SA 21 (SE) 26; *De Villiers v Van Zyl* 2005 1 All SA 443 (NC).

25 Chapter 4, § 4 2 shows that the representation is anomalous in a specific respect: the agent *exercises the incidents of execution in own name,* despite doing so on another's behalf.

26 Although it may be that, if the transferor was herself the *security*-holder*,* she as mere instrument-holder will now be agent for the cessionary.

27 See Chapter 4, § 4 2.

28 *Standard Bank of South Africa Ltd and Another v Ocean Commodities Inc and Others* 1983 (1) SA 276 (A) 288-289:

> "A share in a company consists of a bundle, or conglomerate, of personal rights entitling the holder thereof to a certain interest in the company, its assets and dividends…Normally the person in whom the share vests is the registered shareholder in the books of the company and has issued to him a share certificate specifying the share, or shares, held by him.
>
> Indeed, such a share certificate, duly issued, affords *prima facie* evidence of his title to the shares specified therein…In some instances, however, the registered shareholder may hold the shares as the nominee, i.e. agent, of another, generally described as the "owner" or "beneficial owner" of the shares. This fact does not appear on the company's register, as it is the policy of the law that a company should concern itself only with the registered owner of the shares…The term "beneficial owner" is, juristically speaking, not wholly accurate, but it is a convenient and well-used label to denote the person in whom, as between himself and the registered shareholder, the benefit of the bundle of rights constituting the share vests…
>
> *Although the rights conferred by a debenture on a debenture-holder differ in content from those enjoyed by a shareholder, similar considerations apply to the registration of debenture-holders, the issue of debenture certificates and the holding of a debenture by a nominee.*" [own emphasis]

the content of any security asset is tied together by the "cohesive" effect of the security instrument.[29] From a policy perspective this underpins not only the economic efficiencies enabled by the instrument, but also enables securities' core economic function as *assets*.

Thus, in the absence of a valid and intrinsic *pactum de non cedendo*,[30] the point of departure is that by way of a simple cession the "property in [securities passes] independently of, and prior to, registration of the purchaser…".[31] In other words, in keeping with the posited structure of the security asset, *all patrimonial elements* of the security (including all analogous elements of the security's other competencies) are thereby transferred. The issue of whether one or more individual incidents of enjoyment of a security may be ceded out of a security asset will not be dealt with in this section.

The security certificate plays no formal role in the cession of asset-holdership. It has definitively been decided, in *Botha v Fick*,[32] that delivery of the certificate is not a requirement for an effective cession of the security asset. However, its publicity function is notable. In *Botha*, the court made the following observations:[33]

> "*mens [moet] 'n onderskeid tref tussen twee kategorieë van vorderingsreg. Die eerste is die soort vorderingsreg ten opsigte waarvan 'n dokument die enigste bewys is. Dit is waar die vorderingsreg eintlik in die dokument beliggaam word soos byvoorbeeld 'n verhandelbare stuk, waar die reg nie onafhanklik van die dokument kan bestaan nie. Die ander soort vorderingsreg is een ten opsigte waarvan 'n dokument bewys bied, maar nie die enigste bewys nie; die reg bestaan onafhanklik van die dokument. 'n Voorbeeld van so 'n vorderingsreg is juis 'n aandeel in 'n maatskappy. Die aandelesertifikaat is wel prima facie bewys dat die geregistreerde aandeelhouer wie se naam daarop verskyn die reghebbende is, maar hy mag in*

29 This function is alluded to in Chapter 4, in § 4 1 3:

> "as a locus for the execution of the collective sum of rights and competencies, [the security instrument] facilitates the conglomeration, or bundling, of rights in cases where a security is comprised of more than one personal right. All rights and competencies accruing to a security must, by necessity, be administered through the instrument(-holder), so that these components of the underlying interest are bound together by it."

The point is further elaborated upon in Chapter 6, § 6 3 3 2, this is also discussed, under the *indicium* "*Bundling*", as follows:

> "The [security] instrument increases the economic efficiency of a complex and multi-party borrowing arrangement by creating a single person *to perform towards* (the instrument-holder), irrespective of the identity of the person entitled to the beneficial results of such performance. A corollary of this is that, no matter what the underlying interest consists of, benefits will always *flow through that instrument* – in other words, the instrument has a strongly *cohesive* effect on the various elements of the underlying interest."

30 Such as may be found in the debt securities of private companies (see below at § 8 3), or inherently non-transferable securities such as is the case with the RSA Inflation Linked Retail Savings Bond, attached as Addendum C to this work.

31 See Yeats et al *Commentary 2008* 2-513 – 5-114 and 2-799; and Blackman et al *Commentary* 5-360, as well as the discussion which follows below.

32 1995 (2) SA 750 (A).

33 764.

> *werklikheid nie die sogenaamde 'beneficial owner' wees nie, maar slegs laasgenoemde se genomineerde…*"

In light of the pronouncements of *Standard Bank v Ocean Commodities*,[34] debt securities must also form part of this second category of personal rights.[35] Thus in the cession of (debt) security *assets*, the securities' certificates serve:[36]

> "*slegs…'n bewysaangeleentheid…waarvolgens lewering as 'n belangrike faktor – moontlik 'n deurslaggewende faktor – beskou sal word waar die vraag ontstaan of sessie bewys is al dan nie. Hierdie benadering is van toepassing ook in 'n geskil tussen sedent en sessionaris* inter partes*…*"

Here it is also important to note that particular attention must still be paid to determining exactly when the cession effectively occurred, and that "in most cases that intention [i.e. the required intention to transfer, and take transfer of, the security asset] is present when, and only when, the certificates together with a signed blank transfer form are delivered by the seller to the purchaser."[37]

The importance of the certificate in this regard is further supplemented by its role in ensuring the object of the cession is ascertained, or at least ascertainable, so that the intentions of the cessionary and cedent correspond.[38] For example, from the discussion in Chapter 3 of the transfer of *listed but certificated* securities:[39]

> "a transfer could only be valid (1) once the securities were identified, so that (2) the rights being ceded could be ascertained. At this time the *animus transferendi* would be correspondingly matched by an appropriately informed *animus accipiendi*, and the cession perfected. This concept was taken up in the term "appropriated". Here the certificates played a cardinal role, facilitating the ascertainment which perfected the cession. This also illustrates that certificates are not only evidence of ownership, but also evidence of the *content* (i.e. the beneficial interest) of the securities."

In conclusion, the legal aspects of cession of the security asset (and the second of three components of transfer of *security*-holdership) appear quite clear from the above.

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34 *Standard Bank of South Africa Ltd and Another v Ocean Commodities Inc and Others* 1983 (1) SA 276 (A) 288-289.

35 Debentures are debt securities and the common law definition, or more accurately conceptualisation, of debentures as "written acknowledgements of debt" has already been shown to be essentially obsoleted by more recent legal development. See Chapter 3, § 3 1 2 and § 3 1 3; as well as Chapter 4, § 4 1.

36 *Botha v Fick* 1995 (2) SA 750 (A) 779.

37 Blackman et al *Commentary* 5-363; see also Cassim et al *Company Law* 242 & n 163-166.

38 See Van der Merwe et al *Contract* 394-395 & n 77; Lubbe "Cession" in *LAWSA* § 157 & n 4; and GF Lubbe "Die oordrag van toekomstige regte" (1980) 43 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 117 132.

39 Chapter 3, § 3 2 1 2.

However, in the context of company debt securities, a difficult final problem lies in s 51(5) and (6) of the Companies Act.[40] These sections read:

"(5) Subject to subsection (6), a company must enter in its securities register every transfer of any certificated securities, including in the entry-

(*a*) the name and address of the transferee;

(*b*) the description of the securities, or interest transferred;

(*c*) the date of the transfer; and

(*d*) the value of any consideration still to be received by the company on each share or interest, in the case of a transfer of securities contemplated in section 40 (5) and (6).

(6) A company may make an entry contemplated in subsection (5) only if the transfer–

(a) is evidenced by a proper instrument of transfer that has been delivered to the company; or

(b) was effected by operation of law."

Henochsberg on the Companies Act 71 of 2008[41] seems to suggest that, read with s 37(9)(a) & (b), this provision changes the traditional position regarding the transfer of the security asset of company securities. Section 37(9) states:

"(9) A person

(*a*) acquires the rights associated with any particular securities of a company–

(i) when that person's name is entered in the company's certificated securities register; or

(ii) as determined in accordance with the rules of the Central Securities Depository, in the case of uncertificated securities; and

(*b*) ceases to have the rights associated with any particular securities of a company–

(i) when the transfer to another person, re-acquisition by the company, or surrender to the company has been entered in the company's certificated securities register; or

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40 71 of 2008.

41 Delport *Henochsberg 2008* § 51, 211 & 212(1).

(ii) as determined in accordance with the rules of the Central Securities Depository, in the case of uncertificated securities."

The authors' argument, with some reliance on the work of Rachlitz on beneficial ownership under the Act,[42] is that:[43]

> "[before the 2008 Companies Act] the registration of the transfer of e.g. the share could be distinguished from transfer of the rights in which the share consists, which, as between the seller and the purchaser, occurs (unless the terms of the contract indicate a contrary intention) merely upon an effective cession of such rights and delivery of neither an instrument of transfer nor the share certificate is a requisite of such a cession.
>
> …
>
> Section 37(9)(a)(i) and (b)(i) [of the 2008 Companies Act] provide that a person acquires the rights associated with any particular securities of a company when that person's name is entered in the company's certificated securities register and "ceases" to have those rights when a transfer, a re-acquisition by (s 48) or surrender to the company (e.g. s 164), has been entered into the register. The reference is to 'rights associated with' the particular securities *and in this context, it is submitted, that the meaning is the total rights that comprise the particular security*.
>
> This would suggest that if a shareholder divests himself of the shares, e.g. by a contract of purchase and sale, that the purchaser will only acquire the rights associated with the securities if the latter's name is entered into the register. Before that moment, the transferor holds all the rights associated with the securities, including dividend and voting rights. If the transferee acquires any of these rights, it must be agreed in terms of the particular contract, either expressly or impliedly. The extent of these rights could then make the transferee the holder of a 'beneficial interest'…It would appear that the common law distinction between registered shareholder and beneficial shareholder or owner of the shares, will not apply to the extent as set out above."

This seems to suggest that the Companies Act has made a cession of the security asset impossible without a corresponding transfer of the security instrument. In the certificated context this cannot be correct, for a number of reasons.

First, when read correctly, the Act does not affect the continuity of legal principles regarding nominees (as is dealt with in detail in Chapters 4 and 5), and the rich body of common law that has

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42 R Rachlitz "Disclosure of ownership in South African company law" (2013) 3 *Stellenbosch Law Review* 406.

The views expressed by Rachlitz herein are dealt with fully in Chapter 4, § 4 4, as well as in terms of uncertificated securities in Chapter 5.

43 Delport et al *Henochsberg 2008* § 51, 211 & 212(1) [with certain in-text references removed for clarity; italics are own emphasis]. Incidentally, Cassim et al *Company Law* seemingly does not deal with s 37(9) at all.

developed around this aspect South African company law should not, without extreme caution, be read as so radically altered. Here a lengthy passage of *Commentary 2008* is particularly relevant:[44]

> "Where a separation of ownership and registered title is not prohibited, the rights attaching to certificated securities (e.g. the beneficial ownership) may be ceded by the transferor to the transferee independently of a transfer of registered title. It is questionable whether this is permissible in regard to uncertificated securities. It should not be forgotten that a security often includes obligations, it being implicit that shareholders have the obligation to abide by the memorandum of incorporation. While the rights constituting a share may be ceded without registration of transfer, there is authority that the obligations are attached to registered title and can only transfer once registration is accepted by the company and transferred. Presumably, this is derived from the application of novation under English law requiring the company's consent to the delegation of the obligations...
>
> The preferred view is that the balance of authority (influenced by the English dual ownership construction) appears to favour the conclusion that, generally, in the absence of a restriction the rights attaching to shares can be ceded without registration of transfer and that obligations pass only on registration of the transfer. Where beneficial ownership is separate from registered title, generally the registered holder remains liable to the company for the obligations attaching to the shares but would be entitled to indemnification from the beneficial owner (who hopefully is not insolvent).
>
> …
>
> Foreign jurisprudence based on English law in regard to the transfer of securities should be approached with a great deal of caution in regard to the transfer of securities because English law recognises a concept of 'dual ownership' with legal title generally being transferred by way of registration (at least, traditionally based on novation) and beneficial interests in securities transferring or being recognised in terms of trust law, which can have different consequences to the application of the law of cession under South African law. While this fits into the historical development of English law and its 'dualistic model' of ownership, and even though South African trust law is based on English law and our company law originated from English company law, our courts have rejected the English law concept of a 'constructive trust' and the preferred view is that they have not holistically adopted the English concept of dual ownership."

Separated asset- and instrument-holdership may, and indeed must, be accepted as feature of all registered company securities under past and present Companies Act regimes. As per the outcomes of Chapters 4 and 5, though the position taken above is correct, its foundation of "separate and severable" beneficial and registered (so called) ownership does not perfectly encapsulate the position's true legal basis.

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[44] Yeats et al *Commentary 2008* 2-513 – 5-115.

Second, if s 37(9) is given this literal meaning its outcome would be absurd. This interpretation would render all references in the Act to "nominees" and "beneficial interest" and "beneficial interest holders" moot, as it would make it practically impossible *to separate asset- and instrument-holdership*. If a person could not acquire "rights" in a security without also being made registered holder, there is no possible juristic act which could bring about holdership of the instrument *only* (i.e. as nominee). Instead, *all* rights (including the patrimonial, substantive content of the security asset) could thus only be acquired through register entry. It would also render the current system under which the uncertificated environment operates nonsensical.

From a purely functional-policy perspective, securities must function as readily transferable assets (stores of wealth with a high degree of liquidity). Requiring the full transfer of security-holdership for each and every voluntary dispositive transaction concluded with a security would greatly decrease its liquidity, and by extension its usefulness. It would also greatly reduce market efficiency – for example, a security-holder would always have to administer the security personally and could never outsource the administration to a third party instrument-holder. The economic efficiencies enabled by the security instrument has undergirded the use of registered securities (despite a Civilian system of private law) for over one hundred years, and it is highly doubtful that the legislature intended to do away with this position.

Third, it would cause company securities to function like something akin to negotiable instruments, where register entry "embodies" the full content of the underlying interest. As will be shown in the following section on uncertificated securities, not even s 53 of the Act (which greatly enhances the security instrument's connection with the underlying rights) envisions such an effect.

Finally, Delport et al seem to provide an at least semi-contradictory view in their discussion of s 37 itself, stating:[45]

> "[i]t is submitted that s 37(9) could now have the effect that 'ownership' of securities that are issued will only follow upon registration in the securities register, as acquisition of the rights associated with a share equals ownership of the share because the rights (or rather the competencies in respect of the rights) that comprise the share is 'ownership' of the share. In respect of a transfer of shares the registered holder will still have the rights associated with the share and will be the nominee for the beneficial holder."

If this final point argues that the "rights" in question are instead "competencies in respect of rights" (i.e. not the "beneficial interest") it strengthens the argument for what is proposed below. If not, it further muddies the issue.

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45 Delport et al *Henochsberg 2008*, § 37, 174(2)-175.

Ultimately, the meaning of s 37(9) is unclear. For legal certainty, it must be made unequivocally clear and must be interpreted in a manner which avoids all possible absurdity.[46] This can be done quite simply. The appropriate manner in which to interpret s 37(9) is that it governs *determination* (i.e. *enforceability and realisation*) with respect to rights. This is also supported by its effect on the *issue* of company securities discussed in Chapter 4.[47] Thus, where the section refers to "rights associated with any particular security", this must be taken to mean rights *as against the company* – i.e. the incidents of execution. This will give effect to the intention of the legislature, preserve its usefulness in giving clarity to the meaning of issue, avoid the absurdity of the above interpretation, and uphold the important distinction between asset- and instrument-holdership. Moreover, as shown below, such a reading of this provision actually enhances the law regarding transfer of the security instrument.

8 1 3 Registered transfer – transfer of the security-instrument

The final element of a transfer of security-holdership is registered transfer. In light of Chapter 4, this is the transfer of the security instrument as locus for (holdership of) the incidents of execution of the underlying interest. Chapter 4 has further shown that the security instrument is a separate legal object, capable of holdership in the full sense. Does this affect the current legal position regarding the transfer of securities?

The first question in this regard is whether transfer of the instrument (as governed by a constitutive contract alone or, as in the case of company securities, modified by a particular statutory paradigm) is a cession. The security instrument is not patrimonial in nature, but it must still be seen as a legal object. This is because its *extra-juridical usefulness* gives it *legal value*.[48] The pledge construction of the cession *in securitatem debiti* shows that the entitlement of determination of any personal right may be separately ceded. Thus, it is submitted that the position regarding a more global entitlement of determination over the complex of rights and competencies of a security, as a legal object, is no different.

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46 L du Plessis *Re-Interpretation of Statutes* (2002) 103-104 & the legion authorities found therein (see specifically n 128).

47 See Chapter 4, § 4 2. It also seems to fit the second interpretation of the commentary of *Henchosberg 2008* as above.

48 See Chapter 4, § 4 3 2 1. Whether it has economic value is debatable, but ultimately irrelevant in this context.

However, this particular (technically also limited) cession of the security instrument is not free of formalities. The point of departure that cession is form-free does not imply that cession *must* be form free, and:[49]

> "[s]uch formalities as may indeed be relevant in exceptional cases vary greatly in origin, tenor and function. The consent of the debtor may be necessary in particular cases, either because the law requires it or because the debtor stipulated it in the agreement creating the right to be ceded. Parties may link the operation of the cession to delivery to the cessionary of the contractual documents reflecting the transaction between the cedent and the debtor.
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> …
>
> As a general rule, a purported cession is ineffective if the requisite formal requirements are not met, but this applies only to the extent that the transaction is governed by the prescribed formalities."

In the case of non-company debt securities, the security instrument and its legal effects come from the constitutive arrangement creating and governing such securities. Consider the following elements of RSA Treasury's R208 bond: (1) the "bondholder" is defined in clause 1.1 as "the person whose name is entered into the Register as the holder of any Bonds"; (2) clause 9 ("Register of Bondholders") contains the following:

> "9.2 The Register of Bondholders…:
>
> …
>
> 9.2.8. will only recognise a Bondholder as the owner of the Bonds Registered in that Bondholder's name as set out in the Register; and
>
> 9.2.9. shall not be bound to enter into the Register, the fact that a Bondholder may be holding Bonds in trust or as agent or mandatory for any third party and the Issuer shall have no responsibility whatsoever to such third party."

Clearly the asset and instrument dichotomy is built into the bond by virtue of the above. In order to transfer the security asset, a mere cession will suffice. However, to transfer the security instrument (i.e. "bondholdership" in the above example's terminology) the scheme implies a formality requirement: *entry of the transferee on the register*. Thus the transfer of instrument-holdership of non-company securities requires this additional formality before any of the incidents of execution are

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49 Van der Merwe et al *Contract* 399-400. This is also supported by an implicit concession in *Botha v Fick* that formalities may indeed be imposed on a cession – 1995 (2) SA 750 (A) 777.

able to vest in the transferee. This formality requirement here implies that the general principle that factual effectiveness is not a prerequisite for a valid cession does not apply here.[50]

The case of company securities is slightly more complex but governed by the same principles. Here much, though for debt securities not all, of the arrangements are imposed by the scheme of the Companies Act. The main thrust of these arrangements are found in Chapter 2, Part E of the Act. Specifically, s 51(5)-(6) reads:

> "(5) Subject to subsection (6), a company must enter in its securities register every transfer of any certificated securities, including in the entry-
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> (a) the name and address of the transferee;
>
> (b) the description of the securities, or interest transferred;
>
> (c) the date of the transfer; and
>
> (d) the value of any consideration still to be received by the company on each share or interest, in the case of a transfer of securities contemplated in section 40 (5) and (6).
>
> (6) A company may make an entry contemplated in subsection (5) only if the transfer-
>
> (a) is evidenced by a proper instrument of transfer that has been delivered to the company; or
>
> (b) was effected by operation of law."

When seen in conjunction with a more accurate reading of s 37(9) outlined above, it becomes clear that any transfer of instrument-holdership must be recorded in the company's securities register, upon which entry the incidents of execution are obtained by the acquiring instrument-holder.

The use of the phrase "or interest transferred" in s 51(5)(b), however, bears brief discussion. The authors in *Commentary 2008* argue that "the preferred view is that the reference in s 51(5)*(a)* to a transfer of an "interest" in securities is best interpreted narrowly with reference to the information required in relation to a transfer of registered title and as not directed at generally altering the pre-existing law in respect of a cession of beneficial ownership or as imposing a formality on all cessions of beneficial ownership…"[51] This is a compelling position to take, but ultimately unsatisfactory. Whether security-holdership or instrument-holdership is transferred, it will always only be instrument-holdership that is reflected on the register and thus regulated by the subsection in question.

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50 See specifically Chapter 4, § 4 1 1.

51 Yeats et al *Commentary 2008* 2-834.

Therefore, especially in light of the use of "or" in the provision, the authors' argument is somewhat moot.

Instead, as more fully dealt with in Chapter 9 hereafter, it may be that the phrase is intended to imply that this Companies Act requires enhanced publicity in the transfer of limited (real) interests such as pledge or usufruct in the conclusion of real agreements with respect to certificated securities. Though this is a novel reading of the provision, it is also in keeping with the spirit of enhanced transparency within the Act as a whole, as enshrined in s 7(b)(iii) and demonstrated by the (admittedly somewhat flawed) provisions of s 56. Ultimately these competing interpretations will require definitive clarification, preferably by means of case law or legislative intervention.

The next issue, then, is what is meant by a "proper instrument of transfer" (note that s 37(9)(b) and s 51(6)(b) deal with transmission rather than transfer). It would make sense to assume there is no exact and formal delineation of what is and is not a "proper instrument of transfer".[52]

Historically:[53]

> "[t]he principal purpose of this provision [s 133(2) of the 1973 Companies Act, requiring a proper instrument of transfer] was to prevent the evasion of stamp duty, but the same concern can be raised regarding a transfer of beneficial ownership by way of a cession. A proper instrument of transfer denotes a written instrument such as will attract stamp duty under the relevant fiscal legislation."

At present, the Securities Transfer Tax Act[54] renders this particular point of policy obsolete as the Act does not apply to debt securities.[55] However, there is a second element of functionality to the instrument (also referred to as the "deed") of transfer. It is not, in terms of a sale, the duty of the transferor to ensure transfer of the security instrument, but it is the transferor's duty to do all that is necessary to enable the transferee to secure transfer of the security instrument.[56]

Thus the second functionality of the instrument of transfer (functionally described as "proof of the transfer agreement irrespective of the obligationary agreement")[57] is to enable the issuer to alter the register without the risk that it will do so inaccurately. For example, a company's memorandum of

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52 Delport et al *Henochsberg 2008* § 51 213.

53 Blackman et al *Commentary* 5-363 – 5-564.

54 25 of 2007.

55 See s 1 *viz.* "security".

56 Yeats et al *Commentary 2008* 2-813; Blackman et al *Commentary* 5-357 & 5-364 with n 6-8; Delport et al *Henochsberg 2008* § 51, 214.

This contractual duty is not to be confused with the "doctrine of all effort" which was repudiated as a requirement for valid cession in *Botha v Fick* 1995 (2) SA 750 (A).

57 Delport et al *Henochsberg 2008* § 51 213. See also Yeats et al *Commentary 2008* 2-841.

incorporation, or a similar constitutive provision in the case of non-company issuers, may prescribe a transfer form. If so, delivery by the transferor to the transferee of a duly signed, blank transfer form is exactly what the transferee needs to present to the issuer in order for the transferee to effect transfer with peace of mind.[58]

Further, because the word instrument is used here in its more traditional legal sense, the "proof" required must ostensibly be documentary. Therefore, a "proper instrument of transfer" seems to be any documentary proof which will satisfy the issuer of the existence of a valid transfer agreement, so that a transfer may be safely effected. The form it takes will be a function of the environment in which the particular security operates, as well as the particular factual matrix in question. Nothing more is necessary in this regard, as the principle is clear.

However, this also illuminates the fact that a cession of the security instrument *presupposes the co-operation of the issuer-debtor* for its viability.[59] This is not to be confused with the *consent* of the issuer. This co-operation is not a second formality requirement. As a point of departure, s 51(5) is clear in its use of the word "must", obligating a company to make such a change in its securities register if a proper instrument of transfer has been received. Conversely, a company may therefore not effect a registered transfer without such an instrument or, alternatively, a court order.[60] Though the section appears alterable, so that only "[i]n the absence of some particular term in the memorandum of incorporation, it is not necessary that registration of a transfer be specifically authorised by the directors to be effective, the position being rather that a transferee, on presentation to the company of a valid transfer form, has the right to have the transfer registered unless the directors, where so empowered, refuse to register the transfer."[61]

Further, in the case of securities not issued by companies, it is self-evident that recourse against an issuer unreasonably refusing to affect a transfer must be available to a transferee, but this matter is dealt with later in this work.[62]

What then of the security certificate? A security certificate is a corporeal augmentation of the security instrument, serving a publicity function in the conclusion of juristic acts with respect to the security

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58 However, defects in this transfer form are not necessarily fatal to the transfer of the security instrument – see Blackman et al *Commentary* 5-364-1.

59 The debtor can, of course, in certain instances be compelled to co-operate, evidenced for example in the use of "must" in s 51(5).

This is not to be taken to mean that delivery of a valid instrument of transfer is a prerequisite for the cession of the security asset, as this would plainly not be the case. See also Van der Merwe et al *Contract* 396-397, n 93 & n 96.

60 Yeats et al *Commentary 2008* 2-841.

61 Yeats et al *Commentary 2008* 2-840.

62 See Chapters 10 & 11.

in question. Chapter 4 also posits that it further serves to facilitate the application of certain principles from the law of things to securities.[63] In the transfer of the security *asset* it has no formal role, but will of course be of great evidentiary value in disputes between competing cessionaries.[64]

An ordinary cession requires no publicity, mainly because:[65]

> "apart from the practical need for secrecy to protect the credit-worthiness of the cedent, the difficulty of creating an effective publicity mechanism, and the belief that the incorporeal nature of the asset does not create a significant risk that third parties may be misled by such transfers, seem to play a part."

This is a reasonable basis for the generic approach to publicity in the realm of cession. However, it may be prudent to question the principle, as established (specifically in the context of securities) in *Botha v Fick*,[66] in so far as it relates to the role of the security certificate in transfer of *instrument*-holdership.

First, the court in *First National Bank of SA Ltd v Rozenboom*[67] correctly made the point that a cession cannot automatically place doubt on a cedent's creditworthiness (as was argued *in casu*), and that a "cession of debtors can take place for a number of reasons other than that the cedent is in financial difficulty." Even if this were not the case, the nature of the security instrument is such that transfer cannot have an impact on the creditworthiness of the cedent – it is not a *patrimonial* legal object.

Second, as regards securities, there is no difficulty in creating an effective publicity mechanism: one already exists in the form of the security certificate (and, although to a lesser degree, entry on a security register). This has already been established and need not be further discussed here.

Third, due to the possibility of separated asset- and instrument-holdership and the availability of some anonymity within the resultant nominee relationship, there is an increased risk that third parties may indeed be misled as to the true state of affairs. Moreover, asset-holders' vulnerability to an "underhand cession" by a rogue instrument-holder is far greater due to the nature of the latter's

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63 See Chapter 4, § 4 3 2 3.

64 See the comments in *Botha v Fick* 1995 (2) SA 750 (A) cited above at 283-284 (n 44 & 47), cited with approval by Blackman et al *Commentary* 5-362 & n 4-6; Cassim et al *Company Law* 242 ("[d]elivery is simply evidence that the cession has taken place"), and Delport et al *Henochsberg 2008*, § 51, 210.

65 Van der Merwe et al *Contract* 395-396; GF Lubbe "Sessie in securitatem debiti en die komponente van die skuldeisersbelang" (1989) 52 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 490-491 & n 36.

66 1995 (2) SA 750 (A).

67 [1998] JOL 784 (C) [7]-[11].

holdership.[68] The prominence of estoppel in protecting good faith unlawful holders in the context of securities strongly supports this line of reasoning.[69]

Fourth, an additional economically-oriented factor at play is that the enhanced proprietary aspects of securities could militate in favour of elevating or enhancing the publicity requirement in the transfer of the security instrument.

Nonetheless, despite all of the above, it is submitted that the currently accepted mode of transfer sufficiently discounts these considerations, and there is no need to elevate delivery of the transferor's certificate to a legal requirement for transfer of the security instrument in the certificated context.[70]

Here one must consider the ultimately supplementary nature of the certificate – if the issuer has sufficient evidence, in an instrument of transfer, that a change in the securities register is legitimately required then little more is needed. That makes it doubtful whether transfer can be said to be contingent on the presentation of the old certificate.

Issuing a new certificate is more important. Once a new certificate is issued to the transferee, that certificate will provide adequate, though not definitive, publicity of instrument-holdership (which facilitates juristic acts vis-à-vis the issuer). The issue of a new certificate perfects the transfer of instrument-holdership as the certificate is indeed *part of* the certificated security instrument.

The final issue to be discussed here is the relationship between the transfer of the asset and the transfer of the instrument. In *Moosa v Lalloo*,[71] the court took the position that acquisition of instrument-holdership is not guaranteed to a cessionary of the security-asset. In contrast, the authors of *Commentary 2008* argue, in the context of the restriction on the transfer of shares, that:[72]

> "it is highly likely that the vast majority of purchasers and bystanders would anticipate that the seller would provide the purchaser with the right to registration and be under the impression that, if not an implied term, this would be a tacit term (i.e. that the seller will place the purchaser in a position where the purchaser can procure registration should the purchaser so desire), unless this was expressly precluded. Such right to registration is usually desirable (if not necessary) to fully enjoy the rights of a share. While it is accepted

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68 See also Van der Merwe et al *Contract* 396 n 84, wherein it is noted that *Botha v Fick* 1995 (2) SA 750 (A) did not explicitly consider the threat of the underhand cession generally.

69 See Chapter 10.

70 Note that the authors in Yeats et al *Commentary 2008* take a stronger stance at 2-814, stating that "[w]hile it is not expressly stated as a requirement, the transfer needs to be accompanied by the current certificate representing the securities, as the existing certificate must be cancelled and a new certificate issued by the company reflecting the transferee as the holder."

71 1956 (2) SA 237 (N).

72 Yeats et al *Commentary 2008* 2-824 – 2-825.

> that shares can be sold with beneficial ownership being ceded from one person to the next without registration of the transfer of registered title and that the transferee must apply for such registration, it is submitted that most purchasers would be very surprised to learn that the beneficial ownership acquired upon cession of the rights from the seller only included a conditional right to apply for registration which may be declined."

It is submitted that the principle in *Moosa* is sufficiently mitigated to address the above concerns. The outcomes of Chapter 4 demonstrate that either implicit or explicit control over the instrument-holder is always gained by an acquiring (i.e. cessionary) asset-holder. Thus, surprised as investors may be that they are not entitled to instrument-holdership, their (reasonable) expectation of control over the security is fully met through their entitlement to control the instrument-holder. This control naturally includes that the current instrument-holder may simply be ordered to take the necessary actions to have instrument-holdership transferred to the new asset-holder.

This provides insight into a well-established legal problem: cases where the seller unduly delays completion of the contract (and correspondingly the *perfecta* of the cession of the security asset) in order to keep exercising the competencies associated with that security.[73]

In *Sefalana Employee Benefits Organisation v Haslam*, the court examined the voting rights attached to shares, stating:[74]

> "I know of no principle…which, in the absence of anything more, would have entitled [the purchaser], who had not yet acquired ownership of the shares or paid for them, to dictate to the seller how the seller was to vote pending the passing of ownership. Such a purchaser would obviously not be entitled to vote as if he, she or it were a registered shareholder."

This is undoubtedly correct, as it is only after transfer of the security asset that the purchaser would acquire either instrument-holdership itself, or control over the instrument-holder by virtue of the *ex lege* agency that must arise between the instrument-holder and an acquiring asset-holder.[75]

Contrastingly, Blackman et al, using as persuasive authority *Kells Investments Pty Ltd v Industrial Equity Ltd*,[76] argue that this should not be the case when the seller unduly delays the completion of the contract and cession in order to maintain "voting powers against the wishes of the purchaser, and the latter is ready, willing, able and desires completion of the sale."[77] Yet a full reading of *Kells*

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73 In this regard see Blackman et al *Commentary* 5-359.

74 2000 (3) SA 415 (SCA) 421.

75 See Chapter 4, § 4 3 1.

76 (1984) 9 ACLR 507 SC (NSW).

77 See Blackman et al *Commentary* 5-359 & n 3-4 therein.

shows the decision to have been made in accordance with the law of equity precisely *because* such a remedy was not otherwise available. Thus, lacking a principled basis, the persuasive authority of the decision's application to South African law must be approached with caution.

Blackman et al point further to *Barnard v Carl Greaves Brokers (Pty) Ltd and Others and Two Other Cases* [78] as authority for a similar proposition as applied to a credit sale. This case is useful in that it does not concern the right to vote, but rather the competency of a member to apply for winding up. In *Barnard*, a credit sale of shares was effected and whilst the purchaser had gained asset-holdership,[79] that purchaser had not become instrument-holder (i.e. been registered as a member).[80]

Nonetheless the court found that the purchaser did have the requisite standing, despite not having formally become a member of the company:[81]

> "On the peculiar facts of the current matter I do not consider the fact that Barnard is not yet registered as a member is an obstacle to his resort to section 252. I have already found that Barnard is a shareholder entitled as against the company to obtain the insertion of his name on the members' register. In paragraph 2 of the notice of motion, Barnard has sought an order in the following terms:
>
>> 'That in as much as may be necessary, the [company] is ordered to rectify its Members Register to include and reflect [Barnard] as a shareholder of the [company].'
>
> In my view *it is competent for a shareholder who has not obtained registration of his membership of the company because of opposition or lack of co-operation by the company or his fellow shareholders, but is entitled to such registration, to apply in the same proceedings for an order directing his enrolment on the register of members and, in anticipation of the grant of such an order, as a member for relief* in terms of section 252."

For two reasons this case also cannot serve as authority for the proposition that a purchaser may in certain cases exercise the competencies bestowed by security-holdership without holdership of the security asset *or* instrument.

First, the purchaser *in casu* had already become the asset-holder. A more advanced understanding of the relationship between a purchaser asset-holder and a seller instrument-holder, as per Chapter 4, shows that the purchaser could in any event have compelled the seller *as instrument-holder* to make the s 252 application. This is by virtue of the automatically arising *sui generis* relationship of

78 2008 (3) SA 663 (C).

79 Para [12] (however, see more fully also paras [7]-[11]).

80 [41].

81 [41] [own emphasis].

agency between them.[82] If no co-operation is forthcoming, as seemingly would have been the case in *Barnard*, the remedies of the law of agency, delict (pure economic loss with wrongfulness established through a disregard for that agency) and rectification would remain available. This clarity is facilitated by the more advanced understanding of this form of agency, arising as it does from the underlying proprietary structure of securities. The possibility of the *quasi-rei vindicatio* should also be considered, but whether there is any substantive difference between this and rectification is further explored in Chapter 11.

Second, but related to the first point, is the remedy utilised by the court pre-emptively to deem the purchaser a member for the application for winding up. The court's ascribing of a putative membership to the applicant formed the ultimate basis for the relief in question (a directive to transfer instrument-holdership without submission of the relevant transfer documentation). This sufficiently distinguishes the facts of this case from the proposition Blackman et al purport to use the case for.

Thus, it is submitted that the underlying structure of securities does not allow for a third party, who holds only a personal right (i.e. claim) *to performance in the form of effecting transfer*, to exercise any incident of instrument-holdership herself. The distinction between the entitlement to the aforementioned performance and the entitlement to be on the register becomes particularly important in understanding the protection of holdership as dealt with in Chapter 11.

In conclusion, transfer of the security instrument can be described as a limited cession of the global entitlement of determination (*opvorderingsbevoegdheid*) of the underlying interest of a security, subject to the formality requirement of register amendment. It presupposes the co-operation of the issuer, for which a valid instrument of transfer is, in most cases, key. The issue of a new certificate reflecting the entry of the transferee on the securities register completes the transfer but appears not to be a requirement *for* the transfer. However, the certificate's important role in the good faith acquisition of certificated securities should not be underestimated and is further explored in Chapter 10.

[82] See § 4 3 1. This is also supported by authorities such as *Moosa v Lalloo* 1957 (4) SA 207 (D) as relied upon therein. See also HS Cilliers, ML Benade, B Henning, JJ du Plessis & PA Delport *Corporate Law* 3 ed (2000) para 18.16 – "the transferor holds the shares and the rights deriving from the shares for the exclusive benefit of the transferee. The transferor will have to act in accordance with the instructions of the transferee as beneficial interest holder and owner of the shares."

8 2 The transfer of uncertificated securities

In terms of the statutory framework for the transfer of uncertificated securities, this section will deal only with the provisions of the Financial Markets Act.[83] This is, first, because it seeks to outline the legal position applicable to all uncertificated debt securities, rather than company securities alone. Second, as per s 5(4)(b)(i)(ff), the Companies Act of 2008 must align with the provisions of the former and any conflict which cannot be resolved will be settled by the provisions of the FMA. Last, the relevant elements of the Companies Act are incorporated by reference into the FMA and can be dealt with as provisions of the FMA. In this way, where the FMA appropriates provisions from the Companies Act, this will be fully discussed.

The asset and instrument of a security in uncertificated form operate somewhat differently to their certificated counterparts. This was fully discussed in Chapter 5, and the conclusions of that chapter have important ramifications for what follows.

8 2 1 The statutory framework and transfer

With the outcomes of Chapters 4 and 5 as basis, one may now apply these to the transfer of uncertificated securities.

Prior to the commencement of the FMA, if securities were held collectively (see Chapter 5, § 5 1 3), the asset-holder of uncertificated securities of a specific class and issue held a specifically demarcated co-ownership in an undivided fungible bulk of all securities of that class and issue notionally deposited and thus held (in terms of the custodial function) in the repository of the CSD or CSDP in question. The *extent* of the interest which that co-ownership afforded would have extended only as far as the number of those securities held (in terms of the administrative function) by the relevant instrument-holder. However, if not held collectively, the securities would not commingle and the asset-holder retained full asset-holdership.

Thus the system hinged on the role of the security instrument. An uncertificated security instrument is an electronic ledger entry in the name of the instrument-holder, functioning as the locus for (holdership of) the incidents of execution of that security. Therefore when asset-holdership was not recorded in a segregated and allocated manner within the system, instrument-holdership not only *indicated* but also *delineated the extent* of a particular asset-holder's interest in the fungible bulk of securities entered at register-level. Such instrument-holdership also, as per its function, bestowed

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83 19 of 2012. However, the FMA incorporates provisions of the Companies Act into it by reference, and these sections must thus be engaged with.

the incidents of execution associated with that indicated and delineated interest. Seen thus, in uncertificated form the security instrument fulfilled an even more accentuated publicity function, effectively demarcating the extent of the ownership or co-ownership by indicating to all the world the "correspondence between the legal and the factual situation."[84]

As shown in § 5 1 2 of Chapter 5, the FMA brought about a shift from a CSD and CSDP *repository*- to a CSD and CSDP *account*-based system. The section further posits, on an appropriate understanding of the terms "held" and "hold" in the statutory framework, that one must distinguish between intermediaries fulfilling a custodial function (maintaining securities accounts) and those fulfilling an administrative function (instrument-holdership). Finally, within the custodial function, the section argues that a critical distinction must be made between securities accounts that comprise the securities register and those which do not.[85]

With this analysis as background, § 5 1 3 of the Chapter 5 draws four key conclusions on the nature of holdership within the broader uncertificated statutory framework. First, "ownership" in the FMA should be read as meaning asset-holdership. Second, security assets of the same class and issue are fully fungible legal objects. Third, within the accounts that make up the securities register (i.e. register-level securities accounts maintained by CSDs and CSDPs), one determines first whether the securities are held collectively (by examining the configuration of the securities accounts). If held collectively, one determines the extent of the co-asset-holdership of any end-of-chain investor on the basis of a calculation using the "number or nominal value" of securities held by one instrument-holder in relation to the total number which is held by all instrument-holders in the securities account in question. This is so despite any of the various permutations of intermediation that may occur between asset- and instrument-holder. Fourth, the fungibility of the security *assets* of each respective class and issue of the securities in question is the enabling characteristic of co-asset-holdership within this system, as indicated by the demarcatory function of the security instruments to those securities (which are legal objects, but not patrimonial legal objects).

Therefore, under the current uncertificated securities system in South Africa, *uncertificated asset-holdership of securities* held collectively *is pro rata co-holdership of the incidents of enjoyment*

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84 CG Van der Merwe "Things" in WA Joubert et al *Law of South Africa* 2 ed (2015) Vol 27 § 10.

85 As quoted therein, see Yeats et al *Commentary 2008* 2-605:

> "First, the co-ownership interest in s 37(1) of the FMA applies to 'securities of the same kind *held collectively* by a *participant, authorised user, nominee or external central securities depository* in a securities account or by a central securities depository in a central securities account' as opposed to having application to *all securities* of the same kind deposited with or held by 'a depositary institution or with a central securities depository'. Second, the entitlement in s 37(1) is with reference to 'securities of the same kind comprised *in the securities account or central securities account*, as the case may be' as opposed to 'all the securities of the same kind comprised in the *securities repository or central securities repository*'."

associated with the number of securities of the same class and issue demarcated by instrument-holdership in a specific register-level securities account.

With the position regarding holdership itself now more precisely understood, what are the deeper legal mechanics of transfer of security-holdership, asset-holdership and instrument-holdership of uncertificated securities in the current statutory paradigm?

Section 38(1)(a) & (b) of the FMA reads:

"(a) The transfer of uncertificated securities or of an interest in uncertificated securities on the uncertificated securities register held by a central securities depository or participant must be effected in the manner provided for in Chapter 2, Part E of the Companies Act, where applicable, and the depository rules, by making the debit and credit entries respectively in the central securities account or securities account of the transferor and the transferee kept by the central securities depository or the participant, as the case may be.

(b) The transferee of uncertificated securities or an interest in uncertificated securities referred to in paragraph *(a)* is entitled to all the rights of a transferee of movable property."

Chapter IV of the Act ("Custody and Administration of Securities") explicitly states that this provision also applies to uncertificated money market securities, despite the fact that these securities are dealt with differently with respect to other chapters of the Act. Thus it would appear that *all securities* held in uncertificated form (irrespective of the issuer) are transferable in the manner provided by the Companies Act of 2008. Where bearer securities are immobilised, they are not transferred – their representative registered securities are. The definition of "uncertificated securities" in the FMA also has the effect that immobilised registered securities should be subjected to the same method of transfer.

Turning now to the manner of transfer provided for by the Companies Act, the Act deals with the transfer of uncertificated securities in s 53, the relevant portions of which read:

"(1) The transfer of uncertificated securities in an uncertificated securities register may be effected only-

(a) by a participant or central securities depository;

(b) on receipt of-

(i) an instruction to transfer sent and properly authenticated in terms of the rules of a central securities depository; or

(ii) an order of a court; and

(c) in accordance with this section and the rules of the central securities depository.

(2) Transfer of ownership in any uncertificated securities must be effected by-

(a) debiting the account in the uncertificated securities register from which the transfer is effected; and

(b) crediting the account in the uncertificated securities register to which the transfer is effected,

in accordance with the rules of a central securities depository.

…

(4) A transfer of ownership in accordance with this section occurs despite any fraud, illegality or insolvency that may-

(a) affect the relevant uncertificated securities; or

(b) have resulted in the transfer being effected,

but a transferee who was a party to or had knowledge of the fraud or illegality, or had knowledge of the insolvency, as the case may be, may not rely on this subsection.

(5) A court may not order the name of a transferee contemplated in this section to be removed from an uncertificated securities register, unless that person was a party to or had knowledge of a fraud or illegality…"

Finally, echoing s 53(4) above, s 41 of the FMA reads:

"(1) An entry effected in terms of section 38 or 39 is valid and effective against third parties despite any fraud or illegality that may have resulted in the entry being effected, unless a transferee to the transaction resulting in the entry was a party to or had knowledge of the fraud or illegality.

(2) This section does not modify the order of priorities determined by section 40.

(3) Section 53 (4), (5) and (6) of the Companies Act applies to an entry referred to in subsection (1) with the changes required by the context."

It is important to note, in line with the outcomes of § 5 1 of Chapter 5, that the FMA (as read with s 53 of the Companies Act in its referring specifically to the securities register) appears to provide that transfer can only occur through the debiting and crediting of *register-level* securities accounts, as maintained by a CSD or CSDP.

From these provisions, it is clear that a transfer of security-holdership (full transfer of the security from direct own name security-holder A to security-holder B) is unproblematic. A debit to the account of the transferor and a corresponding credit to the name of the transferee will transfer holdership of the security *in toto*. All that is required is that the CSD or CSDP receive a properly authenticated instruction of transfer (the functional equivalent of the valid instrument of transfer in the certificated context) as per the rules of the applicable CSD. Upon the debiting and crediting, lawful holdership of both the security-asset and -instrument (in most cases irrevocably, due to s 41 and s 53(4) of the FMA and Companies Act respectively) will pass from the transferor to the transferee.

However, outright security-holdership is rarely encountered in the heavily intermediated environment of uncertificated securities. In the majority of cases, asset-holdership and instrument-holdership are separated. Typically, the latter will be held (in terms of the administrative function) by an intermediary instrument-holder – i.e. an approved nominee, whilst at the other end of the chain of intermediation will lie the asset-holder as end-of-chain client. Transfers occurring in this more intermediated context require further analysis.

8 2 2 The transfer of uncertificated instrument-holdership

Transfer of holdership of the security instrument is uncontentious. In accordance with Chapter 5, in the dematerialised context, the security-instrument itself manifests as entry in the securities account of the holder in the uncertificated securities register, and further that this register is comprised of the relevant securities account or accounts maintained by the CSD and CSDPs in question. This entry (in an account maintained for a client) will contain the required details, including the *identity* of the instrument-holder, in the uncertificated securities register, bestowing on that holder the incidents of execution of the security or securities demarcated by the entry.

Therefore, as per s 38 of the FMA read with s 53 of the Companies Act (as quoted above in this section), instrument-holdership is transferred through debit and credit entries in the relevant register-level securities account or accounts (which would then require reconciliation with any further downstream non-register level securities accounts). The debiting and crediting entries will amend the instrument-holdership reflected by the existing entries[86] regarding the transferring and acquiring instrument-holders. By way of example: a *current entry* reflecting the details and holdings of (transferor) instrument-holder X in securities account K maintained by CSDP B will be *debited*, and the *current entry* reflecting the details and holdings of (transferee) instrument-holder Z in securities account L maintained by CSDP C will be *credited* or a *new credit entry* to that effect will be made if

[86] As per the meaning of "entry" in s 1 of the FMA as "an electronic recording of any issuance, deposit, withdrawal, transfer…" in light of the correct (and expansive) meaning of deposit – see Chapter 5, § 5 1 1.

no such entry already exists. This will also be reconciled with the relevant securities account entries of CSD A, reflecting the transfer in the central securities account.[87]

8 2 3 The dynamics of transfer of uncertificated asset-holdership

With this understanding, the salient issue in the transfer of uncertificated securities is transfer of the *security-asset*.

The potential scope of intermediation and the complexity it introduces should not be underestimated. Consider the following example.

In the securities account of CSD R, T Ltd is reflected as the instrument-holder of security A. This is because that is what is reflected in the securities account of CSDP S. Together these two accounts comprise the uncertificated securities register in respect of security A. However, T Ltd is a nominee company of CSDP S. Brokerage Y makes use of the services of CSDP S. Finally, C is the asset-holder of security A, having obtained the security asset by sending a purchase instruction to his broker, an employee of Y. The instruction was matched to a corresponding instruction to sell by B (the disposing asset-holder) to her broker, working for brokerage X. Brokerage X uses a different CSDP, Z, and uses its own "broker's nominee" company, F Ltd. Assuming successful payment, the clearing and settling system of R would have caused a "properly authenticated instruction of transfer" to be generated, causing Z to effect a debit in the securities account reflecting the holdings of F Ltd, and causing S to effect a credit in the securities account reflecting the holdings of T Ltd. In this way, T Ltd became the instrument-holder of security A.

This can be diagrammatically illustrated as follows:

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87 This perspective seems to imply that certain "entries" can serve to *modify* other "entries". It is submitted that this is a perfectly plausible position to take, though it would be contingent on the manner in which the specific CSD in question chooses to operationalise the Act's provisions.

It is also supported by the ostensibly modifying effect that an entry of (as per s 1 of the FMA) "…pledge, cession *in securitatem debiti* or other instruction" can have. See also Chapter 9 below.

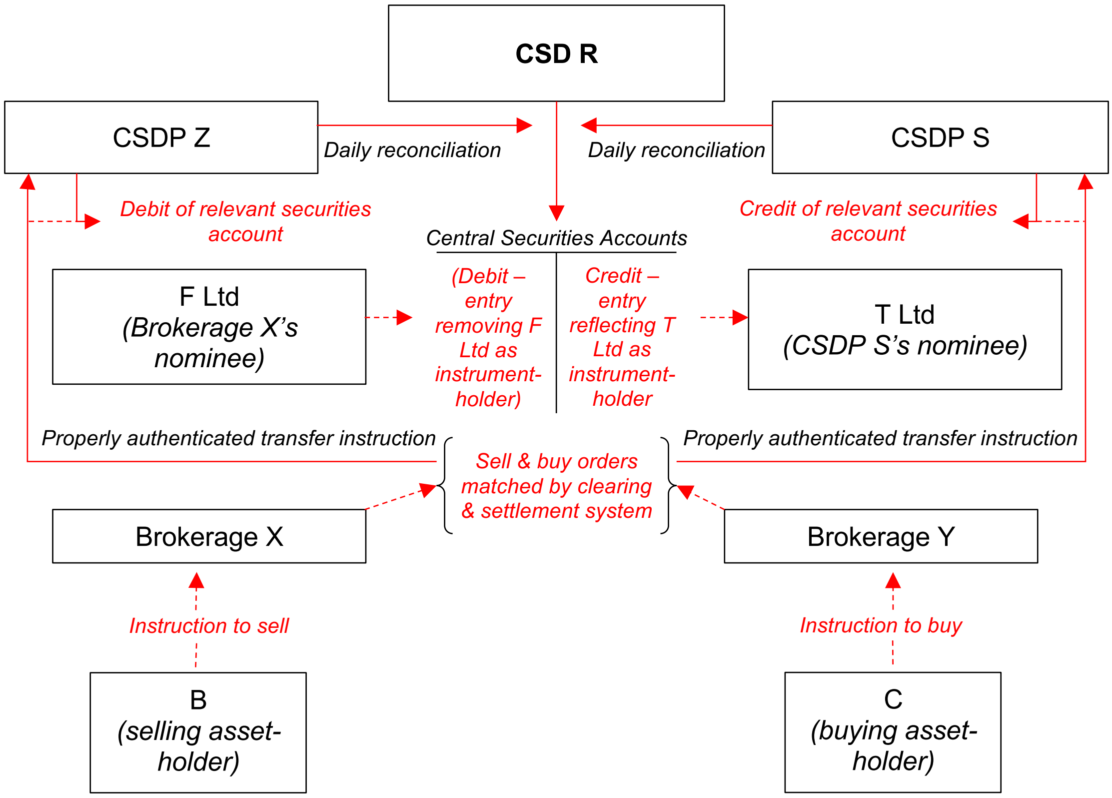

Figure 1: possible example of a matched trade (for the purposes of the example the central securities accounts kept for CSDP Z and CSDP S are conflated; also, any potential non-register level accounts have been omitted).

The key question then is how legally to describe the process of transfer of holdership of the security *asset* from B to C.

The first important feature of transfer of asset-holdership is the unfortunate use of the term "ownership" in s 53 of the Companies Act and similar references in the FMA. In this work, the terminology of various qualified forms of "holdership" has been introduced and adopted as functionally and doctrinally more appropriate.[88] It has further been strongly argued (in § 5 1 3 of Chapter 5) that ownership in this statutory context must be read specifically to refer to *asset-holdership*. These two suggested refinements allow one to make much better sense of the legal position on transfer, especially as it pertains to the security asset.

The key question for this section is whether the security asset can be transferred by mere cession, or whether it also needs a transfer of the security instrument as formality requirement for it to be effective.

Both s 38(1)(a) of the FMA and its object of reference, s 53(2) of the Companies Act, use the phrase "must be effected". In light of the above arguments of function and policy, the use of "must" strongly

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88 See Chapter 4, § 4 1 1.

indicates a peremptory rather than directory meaning. This is uncontentious with respect to the security instrument, but there are both historical and current substantive reasons to take this view with respect to transfer of the security *asset* as well.

From a historical standpoint, indirect support for such a reading of the sections are specifically found in the views of Blackman et al in discussing the regime of transfer of uncertificated securities prior to the Companies Act of 2008.[89] Three of the authors' main supporting points merit discussion here, as they illustrate why the position of the current Companies Act should be read – in possible contrast to its predecessor – as peremptory with respect to the asset.

First, it is pointed out that the *Memorandum to the Bill* which led to the Companies Second Amendment Act[90] specifically indicated that the moment of debiting and crediting is when transfer of both "*ownership and membership*" in respect of uncertificated shares was to take place, as this:[91]

> "ensures that the time at which membership is acquired and at which ownership is transferred is the same and is necessary to avoid doubt and to determine the moment at which complete and irrevocable delivery versus payment of uncertificated securities will occur."

For the authors, this "raises the question whether…s 91A(4) [of the Companies Act of 1973] is intended to…stipulate a compulsory and exclusive formal mode of ceding ownership, rending all other modes void?"[92] A plain language reading of the *Memorandum* certainly leans towards answering this question in the affirmative.

The second point Blackman et al raise is that s 91A(4)(a) used the phrase "*shall* be effected…", but s 42 of the Securities Services Act[93] used the more strongly peremptory word "must". Thus they argued that if there were another, more informal, manner in which to transfer mere ownership (asset-holdership), it would require the "reading down of s 42 of the SSA…reading s 91A(4) as the dominant provision". This is presented as the basis of an argument *for* the possibility of more informal means of transfer of asset-holdership. Yet under the current legislative scheme the argument is no longer possible: all relevant provisions make use of "must" (including s 38 of the FMA in stating the transfer provisions of the Companies Act *must* be followed). Therefore this argument can no longer be made,

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89 See Blackman et al *Commentary* 5-229 – 5-232-6.

90 B49D-98, and 60 of 1998 respectively.

91 Subsection (4) of the *Memorandum*, B49D-98.

92 See Blackman et al *Commentary* 5-228.

93 36 of 2004.

and in this manner indirectly supports a peremptory import of the "must" in the relevant provisions of both current Acts in terms of the transfer of asset-holdership.

The third important point raised is the fact that "the contemplation of a cession of ownership other than by way of entries in the subregisters raises further complexities".[94] Briefly, two such complexities are outlined and can be summarised as follows. First, it would be difficult to explain how, under the privity of the scheme of (agency-based) mandate between the would-be cedent and his nominee, the cessionary would acquire rights against this nominee. Second is the near unacceptable degree of uncertainty regarding true asset-holdership such cessions would introduce to the system, including the deleterious impact it would have on the effectiveness (and therefore policy outcomes) of finality of transfer provisions as now taken up in s 41 and s 53(4) of the FMA and Companies Act, respectively. These issues are equally persuasive today.

Unfortunately, in terms of current authorities there is no uniform view on this issue. It is submitted that, backed by the historical points above, a peremptory reading of "must" with respect to "ownership" should, on balance, be extended to the transfer of asset-holdership.

Vermaas appears to assert that the manner in which the security-asset is transferred is an open-ended matter – a function of the *rules of the CSD* in question. Impliedly, an independent transfer of the security-asset is thus possible without a change of instrument-holdership (i.e. a debit and credit to the uncertificated securities register), if those rules permit it. The core of the argument is as follows:[95]

> "Ownership in certificated shares used to be transferred by way of a contract of cession, provided that there was the necessary intention to pass ownership. Property in the shares passed [independently] of registration on the register of members. In the dematerialised environment, the old Act prescribes that transfer of ownership and membership takes place when the entry is made on the subregisters kept by the participants. The new Act no longer refers to the transfer of membership, but refers to the holders of securities and determines how a transfer of *ownership* must be effected in the case of uncertificated securities. The old Act is, however, silent on transfer of ownership issues in the lower tiers of the holding chain in the subregister system. The new Act also refers to the transfer on the uncertificated securities register that may be effected only by a participant or the CSD in accordance with the section of the new Act and the CSD rules. The new Act is, therefore, also silent on ownership issues in the lower tiers of an indirect non-transparent holding chain and the CSD rules would have to spell out the position.
>
> …

94 See Blackman et al *Commentary* 5-232-5 – 5-232-6.

95 M Vermaas "The reform of the law of uncertificated securities in South African company law" (2010) *Acta Juridica* 87 103-104 & 105.

> The legal concept of full legal ownership cannot automatically be applied in the multi-tiered indirect holding system, unless the beneficial holder is recorded as the full legal owner at the upper tier, such as the CSD."

The core problem with the above is that it does not adequately discern the precise meaning of "ownership" (i.e. lawful holdership). Instead, it distinguishes various "ownership issues" solely by factual context. This seems to imply that where the issue lies within the overall chain of custodial and administrative intermediation will determine the meaning of ownership in terms of the statutory provisions at play. Yet the prior regime as quoted uses ownership *in contradistinction to* membership, almost ineluctably indicating that ownership referred to the patrimonial, beneficial element of securities. It is further clear that s 53(1) refers to the transfer of instrument-holdership, and is quite clearly linked to s 53(2), which then prescribes the mode of transfer of asset-holdership ("ownership"). Thus, in fact, s 53 deals with the method of transfer of instrument-holdership, *and* the transfer of asset-holdership, the full effect of which is then brought into the FMA via s 38.

Chapters 4 and 5 allow a more cogent description of the ownership-membership dichotomy by looking rather at asset- and instrument-holdership, with all that underpins these concepts, coming to a more accurate understanding of these two elements of securities under past and present uncertificated regimes. The implicit share-centricity of Vermaas' view is also immediately obvious, and a viewpoint that can adequately account for all securities, based on their common underlying properties, would be more useful.

Such a variable ownership terminology reflects neither the meaning of the historic legal usages in the securities landscape nor that of company law, which has always traditionally distinguished between registered *title* and beneficial *ownership*. It is not a clear or practical use of legal terminology and does not account for the already separate designations of "ownership" and "title" (and membership).

Finally, there is only one section in the entire statutory framework which, prima facie, appears to support this usage – s 37, specifically subsections (9)(a)(ii) and (b)(ii). These provisions specifically state that a person both "acquires" and "ceases to have the rights associated with any particular securities of a company…as determined in accordance with the rules of the Central Securities Depository, in the case of uncertificated securities…". However, it has already been argued that s 37(9) must be read to refer only to rights as against the company,[96] and there is very little in the way of a persuasive counterargument. To the contrary, the overall position articulated above would seem to lend further credence to the more restricted interpretation of s 37(9) offered in this work. It should

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[96] See above at § 8 1.

also be noted that this provision occurs in Part D, and thus does form part of the portion of the Act which is (at least explicitly) incorporated into the FMA, giving it only persuasive legal effect at best.

Thus, it is submitted that the position taken by Vermaas, as supported (but not truly substantiated) by R Rachlitz,[97] should not be taken to reflect the correct statutory (and supplementary common law) legal position of South African law on this issue. Furthermore, even if it were true that the issue hinged on the rules of the CSD, the Rules of Strate (as the main CSD in the South African securities market) *themselves appear to hinge on the meaning of "ownership"*. As a test-case, the Rules provide as follows:[98]

"Definitions

1.2 In the Strate Rules, unless the context otherwise requires or indicates: –

…

'Transfer' means the transfer of Uncertificated Securities or an interest in Uncertificated Securities by debiting the account in the Uncertificated Securities Register from which the transfer is effected and crediting the account in the Uncertificated Securities Register to which the transfer is effected in accordance with the Strate Rules, and in respect of Securities issued in terms of the Companies Act, in the manner provided for in Part E of Chapter 2 of that Act;

…

6.11.3 Transfer of ownership in any Securities in a Securities Account must be effected by debiting of the Securities Account or Segregated Depository Account from which the Transfer is effected and crediting the Securities Account or Segregated Depository Account to which the Transfer is effected, as the case may be, in accordance with the Act, Companies Act, where applicable, Strate Rules and Strate Directives.

6.11.4 A transferee becomes the owner of the Securities upon the crediting of the Securities Account in the Subregister.

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97 R Rachlitz "Disclosure of ownership in South African company law" (2013) 24(3) *Stellenbosch Law Review* 406 410 – "[a]s the uncertificated securities register also allocates ownership, it can be said that, contrary to certificated shares, in the case of uncertificated shares ownership and registration cannot be separated from each other."

Yet as noted by Yeats et al in *Commentary 2008* § 53 n 139, "[Rachlitz] does not, however, provide a clear basis for this with reference to the provisions of the FMA." It is submitted that the basis for Rachlitz's argument is simply the same position as taken by Vermaas – the notion that the acts' references to "ownership" are indications that ownership may refer to security-, asset- *or* instrument-holdership, depending on the context. This is not supported here.

98 Strate *Rules of Strate (Pty) Ltd* (Registration Number 1998/022242/07, updated as per Government Gazette Number 40188 dated 5 August 2016).

6.11.5 Transfer of ownership of Securities in accordance with Strate Rules 6.11.3 and 6.11.4 occurs despite any fraud, illegality or Insolvency Proceeding that may affect the relevant Securities; or have resulted in the Transfer being effected: but a transferee who was a party to or had knowledge of the fraud or illegality, or had knowledge of the Insolvency Proceeding, as the case may be, may not rely on this Strate Rule."

Therefore, if ownership were taken to mean asset-holdership, the Rules would serve to confirm what is advocated for here. If not the rules do not truly regulate the legal position, as Vermaas appears to assert, because the Rules in question themselves demur on the meaning of ownership.

Moreover, as stated in *Commentary 2008*, this imprecise use of "ownership" gives rise to further inconsistencies between the above and the depository's conception of its securities register:[99]

> "In terms of Strate Rules, a participant's 'Subregister' is defined as meaning 'the record of uncertificated securities held in a Securities Account kept by a Participant in terms of the Strate Rules, which is the *register of ownership* of the Securities deposited therein, and is deemed to be the uncertificated securities register, where applicable'. This definition regards the register as reflecting both the ownership and registered title and, accordingly, does not appear to recognise the possibility of the separation of registered title from ownership, for example where an approved nominee holds the securities for an investor. It is submitted that the reference to the 'register of ownership' should be read as part of the uncertificated securities register reflecting registered title, which will not reflect the owners of the relevant uncertificated securities where they are held through an approved nominee."

It is this that brings one directly, and finally, to the detailed treatment given to this issue by the authors in *Commentary 2008*.[100] Whilst the full scope of the analysis cannot be given the lengthy treatment it deserves here, its key propositions must be dealt with.

The authors, *after* having dealt with "transfer of registered title", discuss this issue as "cession of ownership interest in uncertificated securities".[101] From the work it is clear that it appears to prefer to use "ownership" (roughly) to denote asset-holdership but that "[i]t is also not entirely clear from the FMA and the Act as to what the interrelationship between the uncertificated securities register and the ownership of the uncertificated securities is."[102] It outlines five possible interpretations to

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99 Yeats et al *Commentary 2008* 2-548.

100 Yeats et al *Commentary 2008* 2-1031 – 2-1074.

101 Headings in Yeats et al *Commentary 2008* at 2-1022 and 2-1031, respectively.

102 Yeats et al *Commentary 2008* 2-1032. See also therein:

> "It is clear that approved nominees can hold uncertificated securities for investors and from this it follows that the beneficial interest of an investor ('investor's beneficial interest') is capable of separation from the registered title. Where the uncertificated securities are held by an approved nominee for an investor, the approved nominee has registered title. Applying the ordinary nominee construction, it would appear that the investor is vested with the ownership interest, the approved nominee being regarded as the agent of the investor; *but attempting to reconcile this construction with the apparent conflation of registered title and ownership in s 53(2) and the co-ownership of collectively held securities is challenging*…" [own emphasis]

transfer in light of the use of "ownership" in s 53 of the Companies Act and s 38 of the FMA: (1) "ownership formality";[103] (2) "registered title only";[104] (3) "corresponding ownership and registered title";[105] (4) "relevant securities account";[106] and (5) "dual ownership".[107]

Only the first and the last will be discussed here. In § 5 1 3 of Chapter 5, it was shown that the "co-ownership" and "dual ownership" interpretations of s 37 of the FMA and securities holdership in

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[103] Yeats et al *Commentary 2008* 2-1039 – 2-1055. This interpretation is favoured by the authors. It takes the view that, based on the (also preferred) co-ownership reading of s 37, s 38 of the FMA as read with s 53 of the Companies Act imposes a formality requirement on the cession of the beneficial interest – i.e. as at 2-1035 – 2-1036:

> "where uncertificated securities in a collective 'pool' held by an approved nominee are transferred to another collective 'pool' held by a second approved nominee by way of entries in the uncertificated securities register, effecting the transfers of registered title and resulting in the ownership interest of a disposing investor being ceded to an acquiring investor (assuming it entails a cession from one investor to another), then it is possible to see the transfer of the pro rata number of the uncertificated securities at the uncertificated securities register level as standing 'proxy' for, or evidencing, the cession of the ownership interest as between the respective investors, or possibly as between the respective collective 'pools' (i.e. the collective investors as the pools themselves have no legal personality).
>
> The ownership formality interpretation appears to *require that for an ownership interest to be ceded, at least the respective securities accounts of the cedent and cessionary reflecting the registered title must be debited and credited, respectively*. It is reiterated that lower level entries in an approved nominee's nominee securities account do not form part of the uncertificated securities register and appear to not meet this requirement." [own emphasis]

In this way, "entry in the uncertificated securities register serves a dual function in that, not only does it record registered title to a specific number of uncertificated securities, it also reflects the aggregate number in the collective pool used for calculating the corresponding pro rata co-ownership interest (based on the number recorded in the relevant account, e.g. an investor's securities account maintained by an approved nominee in relation to its omnibus securities account in the uncertificated securities register)…[and] an investor's co-ownership interest can be regarded as indirectly evidenced by the recording of the *pro rata* number of uncertificated securities reflected in the securities register (even though the investor is not identified at that level and he does not own any specific uncertificated securities)." – see 2-1046.

[104] Yeats et al *Commentary 2008* 2-1055 – 2-1057. This interpretation asserts that the requirements of s 53(2) of the Companies Act as read with s 38 of the FMA refer solely to the transfer of instrument-holdership, and therefore that: (1) the uncertificated securities register does not in any way indicate asset-holdership, and (2) asset-holdership is freely transferable.

As noted at 2-1057, the primary arguments against this view are that "[1] the provisions of the FMA [especially s 38 and s 39] favour the conclusion that the purpose of the provision was to ensure *simultaneous settlement by way of electronic payment and transfer of ownership by way of participant securities account entries*, which is critical to the integrity of the trading system…and [2] the desired 'sacrosanctity' of the uncertificated securities register would be undermined if the ownership interests could be freely ceded without any record of such cessions". This line of reasoning is fully supported here, and this interpretation will not be dealt with any further.

[105] Yeats et al *Commentary 2008* 2-1058. This interpretation reads the provisions as requiring "the formality that ownership interest must transfer together with the transfer of registered title *in the limited circumstances where there is a correlation between the registered holder and the beneficial owner*, but then…permit[s] the free transfer (cession) of ownership interests by investors holding uncertificated securities through approved nominees." This view is rejected for the same reasons as outlined by the authors and will not be dealt with any further.

[106] Yeats et al *Commentary 2008* 2-1058 – 2-1061. This interpretation "follows the ownership formality interpretation but instead reads the references to debits and credits in the uncertificated securities register loosely as extending to including the nominee securities accounts maintained by approved nominees where relevant." – 2-1058. This view, though somewhat compelling, is also rejected for the reasons set out by the authors and will not be further discussed here.

[107] Yeats et al *Commentary 2008* 2-1061– 2-1067. This interpretation, as per 2-1061:

> "follows the ownership formalities interpretation but resolves the challenges facing the latter by regarding the registered holder as having legal ownership, while the investor is regarded as having a less direct beneficial interest. It is based on a marrying of the provisions of s 4 of Financial Institutions (Protection of Funds) Act 28 of 2001 with the concept of entries in the uncertificated securities register effecting transfers of ownership….It would have parallels to the English dual ownership construct. This interpretation is predicated on a reversal of the argument that, because registered title and beneficial ownership are severable, s 53(2) cannot be read as contemplating entries in the uncertificated securities register effecting transfers of the ownership interests. Instead, it resolves this dilemma by asserting that because s 53(2) requires ownership to be transferred by way of entries in the uncertificated securities register, this implies that a separation of the ownership interest from the registered title is precluded."

general – as put forth by the authors in *Commentary 2008* – are capable of harmonisation through the outcomes of Chapter 4.

This harmonisation allows one similarly to assess here the compatibility of the authors' dual ownership approach with their preferred ownership formality approach to the transfer of the security asset. From Chapters 4 and 5 it should be clear that the separate but interdependent legal objects comprising the security (the instrument and asset) are capable of independent holdership, but not due to the effect of s 37(5) and its invocation of a kind of statutory trust as per the Financial Institutions (Protection of Funds) Act.[108] Their separateness *and* their interdependence is, rather, due to the private law nature of these objects as they have developed in South African law.

Under the dual ownership approach to transfer, the authors seem to adopt a dual meaning for ownership – registered ownership (holdership of the security instrument) and beneficial ownership (holdership of the security asset). On that basis, they then argued that:[109]

> "where the uncertificated securities are registered in the name of an approved nominee as trust property, then this would only apply to the cession of the ownership interest vested in the approved nominee as trustee. If this is the case, then there would appear to be a persuasive argument that the beneficial interest in the trust property held by the investor as against the approved nominee is distinguishable from the 'legal ownership' (i.e. the trust property) and can be ceded separately. This would be similar to a beneficiary of a trust ceding a vested beneficial interest. Such a cession could be effected with the consent of the approved nominee by way of recording the cession of the investor's beneficial interest in the trust property in the nominee securities account, without a corresponding entry in the uncertificated securities register."

For reasons already outlined, and due to the share-centric development of South African uncertificated securities law, the transfer provisions of past regimes used the term ownership to ensure *simultaneous transfer of ownership and membership.* Taking the superordinate principles evinced by this and applying them to all securities equally demonstrates that the intent (supported by the plain language reading of the relevant provisions) was to ensure the security *asset* is transferred at the same time as the instrument. There is no reason to believe that intent has changed.

Therefore, a middle ground between the ownership formality and dual ownership approaches appears to be possible. This middle ground rests on the notion that there are indeed two separate legal objects *but* due to their being gleaned from the same underlying rights and other competencies they are also interdependent in a manner that does indeed parallel English securities' dual ownership, and reads "ownership" in the statutory context as referring to asset-holdership. Thus it posits that the statutory transfer provisions should be read as imposing a formality requirement

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108 28 of 2001.

109 Yeats et al *Commentary 2008* 2-1071.

(transfer of instrument-holdership) on the transfer of asset-holdership, rather than read as referring to the transfer of one of two types of "ownership". This is also supported by a number of unwelcome second-order "complexities" a formality-free approach would cause,[110] not least of all an erosion of the finality of transfer principle.

Crucially, this middle ground also allows some of the advantages of the dual ownership approach to transfer to be preserved. Specifically, it still facilitates: (1) "the transfer of ownership where the uncertificated securities are held, or are to be held, by an approved nominee whilst preserving the investor's beneficial interest…"; (2) "simultaneous transfer of ownership against the payment of the consideration on settlement, removing any timing differences that [may] arise"; and (3) "the ownership interest vesting in the approved nominee but 'belonging' to the investor in the sense of the investor enjoying the benefits and having control through its mandate with the approved nominee".[111] The fourth and final benefit outlined in *Commentary 2008* is that the dual ownership variant also "facilitates the netting of transfers between the registered holders of the uncertificated securities, as the net ownership interest transfers at the registered title level, and this is unaffected by the delay in the approved nominee updating its nominee securities account to reflect the change in the investor's beneficial interest rights and claims against the approved nominee."[112] This last benefit is not discussed here, and is instead dealt with on own footing in § 8 2 2 2 below.

On balance, all of the above strongly indicates that one must interpret "ownership" as asset-holdership, such that: (1) *asset-holdership* must be transferred by means of a transfer of the security *instrument* – i.e. debiting and crediting; and (2) *instrument-holdership* is what is reflected by means of such debiting and crediting in the relevant securities account or accounts of the CSD and CSDPs.

Therefore, it would seem that the answer to the question of whether "it is also possible to transfer rights to uncertificated securities by way of cession based on the judicial precedent"[113] is firmly in the negative. The converse of this conclusion is most important: the security-asset *cannot* be transferred without a corresponding debiting and crediting in the electronic ledger of a CSD or CSDP, which, by definition, is also a transfer of *instrument-holdership.*

This leaves two important final issues that require deeper treatment : (1) what is the precise nature and effect of this formality requirement?; and (2) what does this imply for transfers in terms of which

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110 See for these the discussion in Yeats et al *Commentary 2008* at 2-1071 – 2-1072.

111 Yeats et al *Commentary 2008* 2-1064.

112 Yeats et al *Commentary 2008* 2-1064.

113 As per Blackman et al *Commentary* 5-173 with n 2.

the identity of the instrument-holder can remain the same, and therefore do not need a transfer of instrument-holdership (register-neutral transfers) and the related issue of netting?

8 2 2 1 The formality requirement: **quasi-traditio**

The exact nature of the relationship between a transfer of instrument-holdership (as formality requirement) and the transfer of asset-holdership (which is separately held and not necessarily reflected within the system of securities accounts) must then be determined. Superficially this seems quite simple – the provisions of the FMA, when correctly interpreted, cause that holdership of the security-asset to transfer to the end-of-chain acquirer *by operation of law* and *simultaneously to* a corresponding transfer of instrument-holdership.[114] Yet, similarly to simply stating something is *sui generis* and thereby avoiding a deeper theoretical inquiry, referring to transfer by operation of law is not sufficient.

For the purpose of this section it will be assumed that transfer requires the substitution of one instrument-holder for another (as is the case in *Figure 1* above) – the possibility of register-neutral transfers (i.e. where the disposing and acquiring asset-holders envisage using the same instrument-holder) is dealt with in § 8 2 2 2 below.

The function of the formality requirement hinges on the control function.

In the uncertificated securities environment, a number of standard permutations of intermediation occur, and these may form the basis of this discussion, despite the possibility of more exotic chains of holdership. By the nature of securities, the asset- and instrument-holders will always lie at opposite ends of the holdership structure. Further, for the purpose of this discussion it can be assumed that the asset-holder is always the end-of-chain "investor". This assumption is made because although juristic or quasi-juristic vehicles for holdership may intercede (for example a trust or a company serving as asset-holder for the benefit of ultimate beneficiaries behind those vehicles), this does not alter the legal ramifications of the issues at hand.

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114 See also in this regard the comments of Blackman et al *Commentary* 5-232-1, stating that transfer of "ownership" is achieved through mere debiting and crediting. See further these authors at 5-228 on the *Memorandum to the Companies Second Amendment Bill* issued as part of the passing of the Companies Second Amendment Act 60 of 1998, legislating s 91A into effect in conjunction with the passing of the Custody and Administration of Securities Act 38 of 1998.

The main driver of intermediary-variation is the identity of the instrument-holder. This holder, in terms of the administrative function,[115] could be an approved nominee or the asset-holder, i.e.:[116] (1) a CSD itself; (2) a CSDP in own name; (3) a nominee of a CSDP; (4) an authorised user in own name; (5) a nominee of an authorised user; (6) some other downstream nominee *client*, in terms of the FMA, of any of the aforementioned parties; (7) some other non-client nominee of the asset-holder; or (8) the asset-holder in own name. Any number of these intermediaries may also be found *within* a broader chain of intermediated security-holdership, acting in a capacity other than instrument-holder (most pertinently either as custodial functionary or client). Thus one of the most complex chains of intermediation is illustrated by *Figure 1* above – asset-holders making use of brokers, whose brokerages use a nominee-company of the brokerage and of the CSDP (respectively) as the instrument-holder of their clients' securities. As already stated,[117] the nature of the relationships between, and including, the asset-holder and the instrument-holder with respect to particular securities are a mixture of agency, mandate, or a combination of both.[118]

Nonetheless, it is strongly contended that all interceding relationships are fundamentally administrative in nature. They serve to ensure that rights exercisable by the instrument-holder are exercised in the manner wished by the asset-holder. Their primary purpose is to facilitate the flow of instructions (e.g. how to vote at a shareholders' meeting) in one direction, and the distribution of benefits (e.g. coupon payments yielded by debt securities) in the other.[119]

In Chapter 4 it was shown that effective factual control of a security, or any subsidiary element of a security, is (as a point of departure) *control over the instrument-holder* for the factual purposes under examination.[120] In the case of lawful asset-holdership (i.e. "ownership"), that control occurs through a *sui generis* agency whereby the instrument-holder acts, albeit in own name and capacity, as instrument-holder, *functionally* on behalf of the asset-holder. The instrument-holder is also, due to

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115 See Chapter 5, § 5 1 generally, and § 5 1 2 specifically.

116 For nominees: provided (*ostensibly* – a fuller discussion of this issue is beyond the scope of this work) that the instrument-holder is duly appointed as per s 1 *viz.* "nominee" as read with s 76 of the FMA.

117 See specifically Chapter 3 in § 3 2 and Chapter 4 in § 4 3 1.

118 See in this regard the excellent discussion in I Meissner *Securities within the realm of private law: a theoretical and practical analysis of the legal nature of shares* LLD thesis University of Stellenbosch (2019) § 13 2 2 3, 231-240.

119 See also Meissner (2019) 244 & 245:

> "Holding or co- holding is therefore a combination of the entitlement to receive benefits on behalf of the owner and a package of duties owed by the holder to its client. These duties flow from agency relationships…
>
> …An account credit is not a share or security. It rather represents all the duties of an agent, or stated inversely, all the rights that a client has against his custodian. It is also a numerical representation of the proportion of higher-tier holdings."

120 See Chapter 4, § 4 3 2.

the unique nature of this agency,[121] beholden to (1) the directives of the latter, and (2) a fiduciary obligation in the carrying out of her function.

Does this state of intermediation change, or more importantly interrupt, sever, or modify this direct *sui generis* agency operative between the asset- and instrument-holder? The answer is, in all likelihood, that it does not. That agency flows from the deeper proprietary consequences of the dichotomous underlying structure of securities, and has been shown to be effective in the certificated environment even in the absence of any express or tacit provisioning for it. It is, for lack of a better word, "embedded", and there are no compelling arguments for asserting that uncertificated securities are any different. Any interceding relationships must be seen as *facilitative* of that primary agency and therefore of a superimposed, secondary nature. In theory, for example, the asset-holder should be fully entitled to communicate instructions directly to her broker's nominee serving as instrument-holder as a result of this position.

However, what does materially differ from the certificated environment is the far smaller degree of intimacy between these respective holders. In many cases these two parties are effectively anonymous to one another. This has significant ramifications for the nature of the effective control which the asset-holder, theoretically, must have over the instrument-holder. From a legal perspective, this is vitally important, as that control facilitates certain proprietary consequences of juristic acts concluded with respect to securities. Adding to the level of complexity is the factual nature of that control – the opacity of the intermediated environment hampers the demonstrability of the legal fact of control.

A second, related modality of the control in question is the fact that end-of-chain investors' relationships with their brokers (or similar authorised users) may be controlled or non-controlled. These terms denote investors with funds and securities held in the custody of brokers, who in turn deal with CSDPs in a representative capacity, and those who manage their holdings directly with a CSDP in own capacity as authorised users, respectively.[122]

Third, there is also a difference between discretionary and non-discretionary arrangements as between end-of-chain investors and their brokers. The former denotes a situation where the relevant intermediary, such as a broker or fund manager, makes investment decisions (i.e. what securities to buy and sell) for the end-of-chain asset-holder. The latter denotes a situation where the intermediary's function is execution-only – she merely executes the buying and selling instructions of that client.

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121 See Chapter 4, § 4 3 1.

122 Blackman et al *Commentary* 5-227.

In sum, what has been established is that: (1) both the security instrument and asset appear to be transferred *simultaneously* upon debiting and crediting; (2) transfer of the former is a formal prerequisite to transfer of the latter; and (3) the heavy degree of intermediation does not theoretically dilute the legal relationship between the asset-holder and instrument-holder, but it does complicate and dilute the factual state of the control exercisable by an asset-holder herself, from a more practical perspective.[123] On this last point, however, one might add that the securities industry's development over the last century appears to have dealt adequately with the potential distance (in terms of intermediaries) between asset- and instrument-holders.

The ultimate question then becomes whether the underlying legal mechanism of the transfer of the security asset is simply what might be called a "black box" *ex lege* effect arising from debiting and crediting[124] or whether something more substantively useful can be said of this formality requirement.

From further analysis it would appear that one can indeed tie this requirement more strongly to existing legal principles, allowing for a better understanding of the dynamics of these transfers.

The transfer of uncertificated asset-holdership is clearly a cession. Further, in the uncertificated securities environment, it is prohibited for any CSD or CSDP to effect a debit or credit in a securities account unless either a properly authenticated instruction to do so has been received, or a court has ordered it to be done.[125] What lies behind such an instruction is a complex set of steps, much of which is automated in the listed environment. The process effectively brings together, typically anonymously, two parties who have reached, in the abstract (due to intermediation), agreement to transfer a particular security asset, or number of such assets, from one to the other. How?

A selling party places an order offering a particular security or number of securities for sale. This offer is at a particular price – either certain, (e.g. R200 per security), or ascertainable (e.g. the best price obtainable over a set period, such as a day's trading hours, or a week). A buying party places an offer to buy a security on the same terms. In the listed environment, these orders are executed on a trading system and sent through to the relevant clearing system (the JSE mainly uses various clearing systems offered by Strate Ltd), along with a great many others.

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123 See § 8 2 1 & 8 2 2 above for "(1)" and "(2)".

124 This seems to be the position evinced by a broad review of the current authorities, albeit implied by way of no further explanation or discussion.

125 Section 53(1)(b) of the Companies Act as adopted via s 38(1)(a) of the FMA. Instruction by court order will be ignored, as it is the simpler and more factually reliable of the two. Similarly, the transfer of uncertificated but unlisted securities will also not be dealt with. It is submitted that if the most complex arrangement – fully voluntary transfer of listed, uncertificated securities – can be fully understood, these other two scenarios become mostly self-explanatory for these purposes.

These two orders are matched via an automated clearing process. Once matched, the transaction must be cleared and settled (i.e. payment must be made and confirmed against delivery by means of debiting and crediting). Thus the transaction is passed on to the clearing and settlement systems, or if the two are integrated the clearing *and* settlement system. The system generates the "properly authenticated" transfer instructions to clear against simultaneous settlement through the national payment system. The instruction affects the relevant security account holders (the CSD, CSDPs, or authorised users), and a debiting and crediting of their respectively applicable securities accounts cause transfer of the security instrument or instruments. This, as discussed, must also cause transfer of the security asset or assets in question.

With this understanding the discussion can now turn to the nature of cession of the security asset, vis-à-vis the formality requirement. Assuming all prerequisites for valid cession are met,[126] *causa* for the cession is clear: the automated matching of complementary offers of sale and purchase (matching). Yet in the South African law of cession, a *causa* and the actual transfer agreement are "functionally and conceptually distinct".[127] In the abstract system of transfer of property found in the South African private law, a valid *causa* is not a prerequisite for cession.[128]

Thus, the more crucial element for characterisation as a cession is the real (transfer) agreement between cessionary and cedent. Does the transactional process discussed above show a clear *animus transferendi et accipiendi* on the part of the end-of-chain seller and buyer?

In the antiquated scrip-based regime of listed, certificated securities transactions could be pre-arranged (i.e. manually cleared on instruction by selling and buying brokers), or be open-ended.[129] If open-ended, the selling broker (acting as mandatory for her client) took cession of the securities from the seller (through delivery in "negotiable form") in order to find a willing buying broker. Once a transaction had thereafter been manually cleared and settled on instruction by the selling and buying brokers, the selling broker would hand over the securities in "negotiable form" to the buying broker. This broker would appropriate the securities to the buyer, which perfected the cession of the security asset between the selling broker (as mandatory) and the end-of-chain buyer through her own broker. However, if the transaction was pre-arranged (i.e. cleared beforehand) the position differed. The

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126 See § 8 1 above.

127 See § 8 1 above.

128 See specifically Van der Merwe et al *Contract*, § 12.2.3, 391 & n 48-51 (notably citing *Grobbelaar v Shoprite Checkers* (710/2008) [2011] ZASCA 11 as confirmation of this position by the Supreme Court of Appeal).

129 For what follows on scrip trading, see Chapter 3, § 3 2 1 2, 111-112, and as referred to therein FR Malan *Collective Securities Depositories and the Transfer of Securities* (1984) 169-182 (and specifically 175, 176 & 178-179) for a detailed account of this process.

"Appropriation" is the act of identifying the particular securities in question as "delivered" to the buyer – see Chapter 3, § 3 2 1 2; and Malan *Collective Securities Depositories* 178-180.

selling broker would not take cession of the security asset, and rather upon receipt of settlement hand it over directly to the buying broker in negotiable form, for appropriation to the buyer. In this case, the cession would take place, albeit remotely and often anonymously, directly between end-of-chain seller and buyer.

The modern automated and electronic clearing and settling process[130] seems more closely to resemble this latter process of pre-clearing and post-settlement appropriation than is initially apparent. The real agreement resulting in transfer appears to stem from a unique set of corresponding intentions on the part of the buyer and seller. The *animus transferendi et accipiendi* are formed upon execution of the buy and sell orders and are open-ended, as was the case in transfers of certificated listed securities, where:[131]

> "[t]he offer to cede, made by delivering to his broker a securities transfer form accompanied by the relevant certificate, is directed either to his broker or to anyone to whom his broker may deliver the documents in terms of the applicable clearing house rules. *The offer to cede is made, it is submitted, 'to whom it may concern'.*"

However, each party's intention is also conditional, upon: (1) matching with a corresponding intention; and (2) payment in terms of the agreement of sale serving as *causa* against effective debiting and crediting – i.e. clearing and settlement. The remaining underlying requirements for a valid cession are also evident. The first is certainty regarding the object of cession (evident in the executed buying and selling orders). Second, agreement on the nature of the transaction is required (this is also self-evident).[132] Third, the parties to the cession must at least be ascertainable, but not necessarily certain. In this context, the heavy degree of intermediation makes it clear that the counter-parties are not the concern of the end-of-chain buyer and seller, but rather that of their intermediating representatives. Through the matching process, the parties are ascertained, but need not be known to one another. Thus it would appear as though, through the application of the ordinary principles of cession, the cession is perfected upon the meeting of the outstanding condition – clearing and settlement.

Transfer of *asset*-holdership ("ownership" as per legislation) must, by way of the interpretation of the FMA put forward above, occur via debiting and crediting of the applicable *register-level* securities accounts – i.e. transfer of instrument-holdership. The effect of this transfer is ultimately what completes the transfer of the uncertificated security asset, as taken up in the clearing process.

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130 See also Meissner (2019) § 13 2 5.

131 See again Malan *Collective Securities Depositories* 175.

132 See Van der Merwe et al *Contract* 394-395 & n 73-77 for numerous authorities in this regard.

A coherent theoretical explanation of this becomes clear through the proprietary principles outlined in Chapter 4, coupled with the fact that clearing and settling of a particular securities transaction is *pre-arranged*. In all scenarios (except in the case of a non-controlled client for whom a CSD administers a securities account in the client's own name) the acquiring instrument-holder takes instrument-holdership upon instruction from the end-of-chain buyer. Strictly it is irrelevant whether, due to intermediation, the acquiring instrument-holder is unaware *in fact* of that buyer's identity, as the instruction ultimately emanates from the prospective asset-holder as end-of-chain buyer.

Once the transaction is cleared and settled, the system has generated and executed the requisite properly authenticated instruction of transfer. This instruction enables a transfer of the security instrument to the chosen representative of the buyer. Crucially, the acquisition of the security instrument in this manner bestows on the acquiring asset-holder *effective control over the instrument-holder*. From this moment onwards the unique underlying properties of securities brings into existence a *sui generis* agency between these holders even in the absence of any express or tacit provision for it. Yet the prearranged nature of the transaction shows that a very similar relationship should already be in place, even prior to acquisition of instrument-holdership. Finally, having shown that the meaning of "ownership" in the Companies Act is of patrimonial import, it confirms that the transfer of the security asset appears to occur simultaneously to transfer of the instrument.[133]

This implies that the statutory requirement of transfer of instrument-holdership to effect simultaneous transfer of asset-holdership voids the common law rule that a cession need not be factually effective for its legal effects.[134] Instead, taking into account the proprietary analyses of Chapters 4 and 5, the following picture emerges. Once instrument-holdership is acquired, the person on whose behalf it was acquired gains what is legally necessary to exert control over the instrument-holder: asset-holdership. Conversely, also at that exact moment, the establishment of the control conferred by asset-holdership causes the transfer of asset-holdership to have *real effect.*

Taken to its logical conclusion, this analysis indicates that (alongside the necessary corresponding intentions) *a statutory form of* quasi-traditio *is required* in order for a transfer of uncertificated security assets to have real effect.[135] Although this seems to be quite a radical theoretical restatement, in reality it simply confirms and reinforces the already existing statutory dynamics of these transfers. What it adds, on the other hand, is the ability to cast an existing legal process in the mould of a pre-existing and well-understood legal concept in South African law. This enables the jurist to make use

[133] See also § 8 2 2 above.

[134] See above in § 8 1 above.

[135] This appears also supported by Meissner (2019) § 13 2 5 2 3 ("Account entries as a formality for cession").

of existing jurisprudence (including a layer of legal policy considerations as well as the more pragmatic, scenario-driven resources of existing case law) and with slight modification bring it to bear on new problems arising from the aforementioned process. In this sense it functions as a useful legal heuristic, as shown below.

It is tempting, due to the form of the transaction, to draw an analogy to the registration necessary for the transfer of immovables, instead of the delivery of movables. However, the publicity function which possession achieves through the requirement of delivery of movables far better describes the legal machanics outlined above than does a process of *quasi*-registration. Whilst both delivery of movables and registration of immovables serve a deeper-order *publicity* function, the element of effective control that underlies delivery is key to the transfer of uncertificated securities as incorporeal movables.

Delivery, in the case of moveable corporeals, is handing over "possession" (which factually denotes effective control)[136] of a thing to the acquirer, completing the real agreement and causing ownership to pass. In the case of transfer of "ownership" of securities (i.e. transfer of asset-holdership) the FMA requires the transferor to hand over effective factual control of the security-asset by transferring the security-instrument to the *acquirer's* chosen representative, thereby bestowing control over the new instrument-holder upon that acquirer.

The underlying policy considerations for requiring *quasi*-delivery further support this conclusion. The South African system of dematerialisation is indirect. It further remains, even after the FMA's expansion of record-keeping requirements to authorised users, at least partially non-transparent. The asset-holder may be traceable due to the mandated record-keeping of the intermediating authorised users and the economic incentives of further downstream parties,[137] but that holder is not reflected on the uncertificated securities register and cannot be known in a real-time transactional environment (not least from the perspective of the clearing and settlement system or systems). This significantly decreases the level of legal certainty regarding the rights, remedies and legal position of the underlying holders (or "owners") of dematerialised securities.[138] In the corporeal environment delivery effects legal certainty due to its publicity function.

Thus, in order both to mitigate this legal uncertainty and to enhance market efficiency and stability, *quasi*-delivery of the security-instrument (which fulfils a publicity function innately in all securities) is

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136 See Chapter 4, § 4 3 2 2.

137 Traceability is discussed fully in § 5 1 2 of Chapter 5 (see § 5 1 3 also).

138 Blackman et al *Commentary* at 5-229 – 5-323-1 provides an *excellent* analysis of the legal problems of certainty surrounding the co-ownership under the previous regime of the Securities Services Act coupled with the Companies Act of 1973.

elevated to a *requirement* for the effective transfer of asset-holdership. Once there is transfer of the security-instrument, there can be no doubt that both the interest and the entitlement to *execute* that interest are effectively controlled by the acquirer (as new asset-holder).

This also provides the necessary proprietary foundation for the effective application of the principle of irrevocability of transfer. The full impact of the *quasi*-delivery construction on s 53(4) of the Companies Act read with s 41 of the FMA is dealt with in Chapter 10.

Finally, what if a specific asset-holder wishes to change her CSDP or broker, without losing holdership of her securities? Due to the above, this presents no problem. The outgoing instrument-holder's account will be debited, and the new instrument-holder's account will be credited. Due to simultaneous transfer of security asset and instrument, there is no moment in time when the asset-holder does not have specific and publicly demarcated effective control over her security asset through control of the applicable instrument-holder.

8 2 2 2 Register-neutral transfers and netting

The example given in *Figure 1* above is an example of a register-affected transfer, as a debiting and a crediting in the legally effective securities accounts was necessary within the overall scheme of the transaction. However, if both B and C's brokers were making use of the same nominee, or if they were making use of the same broker then it would appear that – but for the conclusions of the previous section – no securities accounts entries (i.e. no debiting and crediting) would necessarily be required to transfer the security-asset from B to C.

This problem is also tied to the issue of netting – i.e. scenarios where the clearing and settlement system only produce authenticated instructions of transfer for the *net* transfers of instrument-holdership required to effect all trades over the netted period. If a transfer of instrument-holdership is required for each transfer of asset-holdership, not all the *gross* transactions would comply with that formality requirement. The authors in *Commentary 2008*, in discussing their ownership formality approach, state that:[139]

> "not all transfers of ownership will involve a transfer of registered title, especially where the approved nominee that held registered title for the transferor will continue to hold registered title for the transferee. This raises the question as to whether, in such circumstances, a transfer of the ownership interest can take place without entries in the uncertificated securities account, or must there nevertheless be a debit and credit entry in the uncertificated securities register (i.e. both against and in favour of the approved nominee,

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[139] Yeats et al *Commentary 2008* at 2-1051 – 2-1052 [own emphasis].

> with no net change in the nominee's aggregate holding)? From a registered title entry perspective, it is unnecessary to record the transfer in the uncertificated securities register because there is no change in registered title and from an accounting perspective alone, the transfer of the ownership interest could simply be recorded in the relevant approved nominee's securities account. If this were accepted…it appears to run counter to the peremptory wording of s 53(2) that states that debit and credit entries must be made to effect a transfer of the 'ownership'. Read strictly, even where there is no change in the registered holder, the transfer should still be effected by way of a debit and credit entry in the securities account of the relevant registered holder in the uncertificated securities register…The most apparent motive for requiring this would be to ensure a clear record in the uncertificated securities register of all transfers of ownership interests and to facilitate simultaneous settlement, and possibly also to ensure that there is, at all times, a correlation between transfers of ownership interests reflected in the approved nominee's securities account and transfers in the uncertificated securities register (marred by the slight timing delays in recording the entries at the different levels). *If this is the aim, then the netting of transactions would not be compliant*, because where netting takes place there are no individual entries in the uncertificated securities register for each specific transfer of an ownership interest effected by each investor. And the investor is not identified at the time of the 'netted' transfer because transfers between relevant accounts are effected by 'set-off' and only the net amount is transferred, without identification of the cedent and cessionary at an investor level.
>
> Such a strict reading of s 52(3) does not correlate with s 35(2)*(y)* of the FMA which requires a depository's rules to provide for 'netting arrangements if a transaction in one or more categories of securities settled through the central securities depository settle on a net basis'. Presumably, this provision contemplates netting at least at a registered title level in the participant maintained securities account and possibly in regard to accounts in the central securities account."

Thus register-neutral transfers present a significant problem.

It has been shown, quite definitively, that asset-holdership cannot be transferred without *quasi*-delivery – i.e. transfer of the security instrument by debit and credit. It would thus appear that register-neutral transfers, including those under scenarios of netting, cannot occur. Does this position result in a good policy outcome?

The JSE has been, until recently,[140] the only securities exchange in South Africa, and by association Strate Ltd has remained the only CSD in the securities trading environment. Strate provides most of the JSE's clearing and settlement services. The overwhelming majority of the South African listed securities sector's liquidity lies in the JSE and is thus under the care and custody of Strate. However that system is historically informed by the so-called "subregister model", in which it was the

[140] The ZAR X exchange completed its first trade on Monday 20 February 2017, see – Fin24 "Trading kicks off on SA's newest stock exchange" (20-02-2017) *Media24* <http://www.fin24.com/Markets/Equities/trading-kicks-off-on-sas-newest-stock-exchange-20170220> (accessed 31-01-2021).

subregisters of the CSDPs that enjoyed primacy.[141] This was, in principle, reversed by the passage of the Financial Markets Act, which provides that:[142]

> "[i]f the records of a licensed central securities depository are inconsistent with those of a participant regarding securities deposited with the licensed central securities depository by the participant, the records of the central securities depository are deemed to be correct until the contrary is proved."

Despite this formal change, the system remains largely (though not entirely) CSDP-driven, and few transactions are concluded in a manner where the register of the CSD is debited and credited directly. For this reason, practically, the reconciliation between the two consists mainly of the updating of Strate's central register rather than *vice versa*. Moreover:[143]

> "as a result of the majority nominee holding accounts, the Strate subregister system may be classified as a non-transparent system."

This non-transparency persists and the identity of asset-holders is only in certain instances reflected in the uncertificated securities register, making many (if not most) end-of-chain investors unidentifiable from the accounts within the custody and administration system in real time or thereafter (see Chapter 5, § 5 1 2 and 5 1 3). This is despite the inclusion of (the innately rather problematic) s 56 of the Companies Act as part of the FMA's wholesale appropriation of Part E of Chapter 2, as well as allusion to it in the CSD Rules of Strate.[144] The fact that the FMA now requires record-keeping by authorised users does not have any impact on transparency within the trading system itself, and there may indeed be further downstream intermediaries not subject to these formal statutory record-keeping duties.

In that light the following observations are still of relevance, not only formally to the subregister-system, but also more substantively to the operational realities of how Strate's ostensibly reformed system functions at present:[145]

> "The subregister model has implications for systemic risk in South African financial markets. All the participants currently run their own custody systems, none of which is tailored to be inter-operable with any other. Should a participant fail, it would not be possible to quickly and easily transfer beneficial shareholder details onto the system of another participant. It would also be difficult for the clients of the participant to prove ownership of their shares in the lower levels. If the CSD operates a *transparent and centralised*

141 Vermaas (2010) *Acta Juridica* 98-102.

142 Section 43.

143 Vermaas (2010) *Acta Juridica.*

144 Para 6.8.2.4.

145 Vermaas (2010) *Acta Juridica* 100 [own emphasis].

> register, it has a more-or-less up to date version of beneficial shareholding details at all times. Furthermore, each participant will have a custody system that is able to interface with the Strate register. Should a participant fail, the CSD can easily transfer the beneficial shareholding record to another participant with the result that settlement will experience minimal disruption. The counter argument is a concern that centralisation of records of ownership has a potential to introduce systemic risk, particularly if changes to the system result in data corruption or system failure. These risks can be well mitigated, primarily through the provision of strict disaster recovery mechanisms and associated processes and procedures."

Without transparency *in principle* as a property of the system (rather than as a property of some cases within such a system), centralisation of the register does not address the root cause of these problems – namely that it could be "difficult for the clients of the participant to prove ownership of their shares in the lower levels". Moreover, the outlined "systemic risks" of centralisation remain. It seems that in the practically entrenched non-transparent system currently in use, one of the underappreciated ways in which this risk is currently mitigated is the legislative requirement of *quasi*-delivery. What this requirement effectively brings about is that all uncertificated securities transfers are elevated to a *legally relevant securities register.* It creates a record of the transaction with both the relevant CSDP and the CSD, improving the security of the transaction data and reducing the risk posed by failure of any particular CSDP. It also provides a record of the transfer in cases where the records of authorised users (or nominees) are in dispute. If register neutral transfers were accepted as possible (i.e. not requiring a transfer of instrument-holdership), authorised users' lower-level records alone would determine asset-holdership. If such "off-system" transfers were countenanced by the legislation it would effectively bypass the finality of transfer provisions, as there would be no register entry that one could regard as irrevocable. That does not seem to be a sound policy outcome.

A final consideration is whether the position taken here is unduly disruptive to the currently utilised practices of register-neutral transfer. Taking the position, as Blackman et al suggest, that it is "necessary to nevertheless debit and re-credit the same account to record the transfer of ownership"[146] is not overly disruptive, and eminently practicable. Thus it is suggested (albeit with caution) that any register-neutral transfer practices are currently non-compliant with the FMA as read with the Companies Act. However, remedying this may not require overly costly remediation efforts. A simple solution is the implementation of (otherwise redundant) debiting and re-crediting of the account of the same instrument-holder. This ensures *quasi*-delivery, which simultaneously establishes the agency required for control, and the control required for the real agreement to take

146 Blackman et al *Commentary* 5-232-2. In context the authors suggest this must be the case but for the possibility of a transfer of the security-asset without a security instrument transfer, and this possibility is refuted above.

effect. In doing so it also more reliably demarcates the interest of the asset- or co-asset-holder in the register, and enhances the stability of the trading system both legally and from a risk perspective.

8 3 Restrictions on the transfer of debt securities

The underlying constitutive arrangement that gives rise to a debt security is contractual. This is true regardless of whether the issuer is a company or not. In the case of non-company securities, restrictions on the transferability of debt securities – if they are to be regarded as "original incidents of ownership of a [security]"[147] – must be created in terms of the constitutive arrangement giving rise to those securities. This is an important point, as "our courts…distinguish between restrictions in respect of what are referred to as pre-existing rights by way of contractual undertaking by the person holding the rights and those restrictions that are an intrinsic detraction from the rights themselves".[148] This section will deal principally only with so-called *intrinsic* restrictions.

These restrictions will arise from a contractually valid *pactum de non cedendo* included in the terms and conditions that govern the coming into existence and further operation of that security. Further common law restrictions, such as transfers which are *contra bonos mores*, or restrictions due to proceedings regarding a security as subject matter of a legal dispute which has reached *litis contestatio*, are also applicable here.[149]

Company securities, on the other hand, are modified by both the operation of the Companies Act and the particular issuer's memorandum of incorporation, and restrictions may be "imposed by the common law, the Act, or by the company's articles".[150] Examples of the latter two include the restriction on the transferability of a private company's securities found in s 8 of the Companies Act of 2008, or the prerequisite of directors' approval to alienate a public company's securities (as built into a memorandum of incorporation). Due to the differences between company and non-company securities, each will be dealt with separately.

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147 *Borland's Trustee v Steel Brothers & Co Ltd* [1901] 1 Ch 279 288, cited with approval in *Smuts v Booyens; Markplaas (Edms) Bpk v Booyens* 2001 (4) SA 15 (A) para [14].

148 Yeats et al *Commentary 2008* 2-874 – 2-875.

149 See Lubbe "Cession" in *LAWSA* § 163, or Van der Merwe et al *Contract* 407-408.

150 Blackman et al *Commentary* at 5-189 & n 8, repeated in Yeats et al *Commentary 2008* 2-873 – 2-874.

8 3 1 Restrictions on the transferability of company securities

The Companies Act of 2008 is not clear on whether the creation, existence or content of debt securities needs to be reflected in the memorandum. If, as indeed seems to be the correct position, debt securities can exist free from (at least standard) company memoranda, the constitutive function that the memorandum fulfils for shares is not necessarily mirrored with respect to "debt instruments". However, no determination on this issue is necessary for the present discussion. As per s 8(2)(b)(ii)(bb) of the Companies Act of 2008, the transferability of the "*securities*" of private companies must be restricted.

One must begin with the policy basis for restrictions on transferability. As it relates to shares:[151]

> "the object would seem to be that of protecting the public and restricting speculation…[and] to allow existing shareholders a measure of control over the identity of the company's shareholders, to maintain an existing pattern of control, or to prevent one [or] more shareholders from obtaining control by purchase from other shareholders."

There is no reason why these elements of policy should not, at least approximately, hold true for the shares of more closely held (i.e. non-listed) *public* companies in which a choice to restrict transferability has been made. Further, both arguments (investor protection and control) should also be correspondingly applicable to any company debt securities to which voting rights have been attached. These securities appear to function similarly to redeemable preference shares, with the important exception that they typically have a finite lifespan.

The problem at hand is that, at face value, the argument regarding the maintenance of "existing patterns of control" does not seem as readily applicable to debt securities without voting rights. This non-voting category of company debt securities is by far the more prevalent. The key difference between voting and non-voting debt securities is that transfer of non-voting debt security-holdership is a change in the identity of *creditors* rather than those who are able to exercise control over the management of the company (holders of equity). Because no voting rights change hands, the profit-sharing masters of company policy remain the same. The transfer of debt security-holder merely effects a substitution of a special class of creditors.

Yet the policy goal of protecting the investing public will apply in both the private and more closely held public company settings. First, from the perspective of the investing public (which, in the non-listed environment, must be assumed to be unsophisticated in terms of investment acumen),

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151 Blackman et al *Commentary* at 5-184 – 5-185.

protection against ill-advised lending seems equally important as protection against investment in unsound equity.[152]

Ultimately, however, the policy position is primarily aimed at private companies, forming one of the two criteria underlying the private-public distinction (alongside the prohibition on offering securities to the public).[153] Why?

As shown in § 2 2 3 of Chapter 2, the regulation of the domestically influential English securities market was historically mainly left to private actors in the past. This was so despite a number of market failures experienced as a result of the increasingly public availability of the incorporated form. The noted exception to this principle, which is crucial for present purposes, was the emergence of stringent financial reporting and prospectus requirements for companies whose securities were publicly traded. As seen, this was adopted into company law by the English parliament primarily to minimise informational deficiencies (and outright fraud) in the more volatile, speculative and overly-optimistic equity securities markets that arose around companies in the 18th and 19th centuries.

The measure proved extremely successful and became a lasting feature of English company law. Consequentially, as part of South African law's broader reception of English company law principles, stringent financial reporting became a key feature of domestic company legislation. It enjoyed similar success and, as shown in § 3 1 2 of Chapter 3, this regulatory tool featured prominently in the further refinement-by-commission of South African company law throughout the 20th century. It remains a vital control measure in the regulatory arsenal of company law even today.

Yet the scope of application of this regulatory control measure was, and remains, subject to an important qualifier. Namely, where: (1) company securities are not traded in the public domain, or (2) the integrity of their financial information is otherwise not judged to be of systemic importance, *the stability, efficacy, and degree of investor-protection of the securities and broader capital markets at large is not contingent on their being held to such stringent reporting standards.* In fact, where either of those conditions are not met, the economic cost of imposing such high financial reporting standards on businesses outweighs the benefits the measure may have, and the net result is a chilling effect on entrepreneurship. In such cases the better overall policy choice seems to be to make it as cost- and resource-effective as possible to profitably establish and maintain small to medium sized businesses with the benefits of juristic personality and limited liability.

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152 It should be noted, though, that due to a lack of volatility (and thus scalable gains) relative to equity, speculation in debt securities would be almost, but not entirely, fruitless. See also Chapter 2, § 2 3 1.

153 Section 1 *viz.* "private company" & s 8(2) of the Companies Act 71 of 2008.

That, it is submitted, broadly underlies the essence of the public-private distinction with regard to companies. The distinction enables company law to apply different economically calibrated rules to companies which meet either of those criteria compared to those who do not. This calibration is naturally informed by the lawmaker of the day's position on how company law, and thus companies themselves, can be harnessed in furtherance of the prevailing public and economic policy objectives of the legislature and executive government at any given time.

If companies wish to make use of the access to public and institutional capital markets (and other benefits) that free transferability provides, they must comply with the stricter rules and regulatory control measures that apply to public companies. In modern form these measures have developed to include more than financial reporting and prospectus requirements, most notably now incorporating a far broader battery of requirements for public offerings of company securities, more stringent corporate governance requirements, and enhanced transparency measures (for example the maintenance of a register of beneficial owners of public company securities). Chapter 3 of the latest iteration of the Companies Act also attempts to address more directly cases where the second condition above is met, but the first is not, but this is a new feature of company law with little bearing on the argument at hand.

Conversely, if companies opt not to avail themselves of the advantages of free and public transferability of their debt and equity, but at the same time free themselves of costly compliance obligations, they are *compelled* to restrict the transferability of their securities.

Therefore, though stability of company ownership does not seem readily applicable to debt securities, its counterpart of investor protection alone appears a sufficiently sound policy basis for the restriction of the transferability of all securities.

Whatever the underlying policy position, the fact remains that there are significant *practical* issues in formulating and implementing restrictions on company debt securities.

Two illustrative restrictions are the pre-emption right for holders to take up debt securities *pro rata* to their existing holdings and the board of directors' right to refuse any transfer. Based on the policy outcomes above, when these restrictions are used it would be wise to consider crafting a specifically bespoke mechanism for the restriction of transfer of debt securities, as those commonly used to restrict the transfer of equity may not be appropriate or effective. Perhaps there are even different, debt-oriented restrictions which may be more appropriately – or more effectively – made use of.

Regardless, the prohibition itself is unambiguous. This is well illustrated by the fact that all private companies with debt securities listed on the JSE had to convert into public companies in order to comply with s 8 of the Act.[154]

Further, the precise nature of this prohibition was best addressed, though in the context of both shares and the 1973 Companies Act, by the court in *Smuts v Booyens; Markplaas (Edms) Bpk v Booyens*. The court begins with the impact of the nature of the private company on the nature of its shares, noting that:[155]

> "oordragsbeperkings ten aansien van aandele [is] 'n onontbeerlike eienskap van 'n privaatmaatskappy soos in die Wet omskryf. Die Wet bepaal by wyse van definisie dat 'n privaatmaatskappy een is wat so 'n beperking in sy statute bevat; by onstentenis hiervan is dit regtens onmoontlik dat die betrokke entiteit 'n privaatmaatskappy kan wees. Dat die tersaaklike beperkings betrekking het op die regsaard en -essensie van só 'n maatskappy is (soos later sal blyk) myns insiens van belang by die bepaling van hulle effek en betekenis…Die gebruik van die omvattende begrip "die reg" in art 20(1)(a) is opvallend. Dit dui op die wetgewing se bedoeling dat die aandeelhouer se [bevoegdheid] om die maatskappy se aandele hoegenaamd oor te dra in die statute beperk moet word."

This position is extended in the context of the 2008 Companies Act to all securities by means of s 8(2). In s 20 of the Companies Act 6 of 1973, the restriction applies only to shares (though the prohibition on offers to the public extends also to debentures); the 2008 Act refers to all securities. The 1973 Act also stated expressly in s 91 that *shares* were transferable (impliedly: only) in the manner provided by the Act;[156] in the 2008 Act, this provision's equivalent is found in s 37(1), but also speaks only to shares. Nonetheless, because s 8(2) is the contextually operative provision and refers to "securities", there is no ambiguity about the rule's applicability to debt securities.

Third, it requires a restriction of the *transferability* of these securities rather than merely a restriction on the right to transfer them.[157] This quite firmly indicates an intent that speaks to *intrinsic* restrictions on the transferability of securities as "original incidents" of the underlying interest.[158] It is further submitted that the portion of the *Smuts* ratio quoted above also, when read with s 8 of the Act, ensures that the restriction is operative regardless of whether the memorandum is part of the

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154 CIPC *Non-binding Opinion of the Companies and Intellectual Property Commission in terms of s 188 (2) (b): Guidance on the interpretation of the provisions of the Companies Act, 2008, on the limitation of listing debt instruments on the JSE by private companies and the consequential effect of such listing*) 2 April 2012.

155 2001 (4) SA 15 (A) paras [8]-[9].

156 *Smuts v Booyens; Markplaas (Edms) Bpk v Booyens* 2001 (4) SA 15 (A) para [8]-[9].

157 See also PA Meskin et al Henochsberg on the Companies Act 71 of 2008 (SI 11 – 2015) § 8 5 1[2G] – "It is submitted that "right to transfer" is much more limited than "transferability", but the authorities on the former should apply to the latter (but not *vice versa*)."

158 See also Chapter 4 § 4 1 1.

constitutive arrangement of debt securities in question or not (and irrespective of the fact that s 15(6) of the Act limits the binding nature of the memorandum to shareholders and directors). Here it may also be reasoned that the nature of any security is subordinate – where relevant – to the nature of its issuer. In this case what is relevant is the manner in which that issuer may or may not issue and then further deal with all classes of its securities. In other words, what is key is the effect of the memorandum on the issuer rather than its effect on the security itself.

The memorandum, as the source and governing instrument of a company's capacity to act, should be seen inherently to limit any secondary, contractual constitutive arrangement which creates debt securities. As discussed in Chapter 4,[159] the ratio of *Smuts* indicates that an intrinsic restriction on the transferability of private companies' securities is an *a priori* structural feature of those securities – in the court's words an "[*onontbeerlike*] *oorspronklike eienskap in die aandele self…*".[160] The embeddedness of intrinsic restrictions is due to the nature of the company rather than wholly due to the nature of the security – i.e. private companies are private in part because the transferability of their shares is restricted. Here the thinking seems to be that the nature of the entity as "parent" is an overriding determinant of the nature of the security as "child". Whilst company debt securities are not necessarily created with the company's memorandum as constitutive source, the *restriction itself must* be contained in the memorandum. Therefore, any restriction applicable to any kind of security in the memorandum must inherently restrict the transferability of company debt securities as an implicit limitation *upon*, rather than within, the constitutive arrangement creating the security in question.[161]

There is some authority for the view that this restriction only applies to a transfer of the underlying interest – i.e. asset-holdership.[162] However, the better position appears to be reading a global effect into such restrictions, such that they extend to the transfer of security-, asset-, or instrument-holdership of securities. This is for two main reasons.

First is the superordinate effect of the restriction as emanating from the memorandum – its terms, in accordance with s 8(2), must reside within the memorandum. Therefore any restriction as contemplated in that section should be seen as operative over the entire complex of underlying rights and competencies, affecting that complex as a whole, or in the words of the *Smuts* judgment "*in die*

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159 See § 4 1 1.

160 *Smuts v Booyens; Markplaas (Edms) Bpk v Booyens* 2001 (4) SA 15 (A) para [17].

161 See also Yeats et al *Commentary 2008* 2-835 on the difference between intrinsic and extrinsic restrictions.

162 This is the view in both Blackman et al *Commentary* 5-5-185 – 5-186, supported in FHI Cassim et al *Contemporary Company Law* 2 ed (2012) 243-244 & n 178 (with a number of other authorities cited therein).

volle en tegniese sin van die woord",[163] as they must – and will – be governed by the Act and the memorandum in this regard.

The second is more practical – the likely presence (in the case of debt securities) of a trustee (fiduciary or in the fuller technical sense). Such a representative would hold more power and responsibility than is evident in the agency of an instrument-holder acting for a single asset-holder, as she directly or indirectly exercises the incidents of execution on behalf of entire *classes* of asset-holders. A broader interpretation of the meaning of "restriction", extending it also to instrument-holdership, protects the stability of arrangements of trust despite changes in asset-holdership. Moreover, such arrangements are typically institutionalised rather than voluntary. The power to prevent transfer of instrument-holdership to someone other than a soon to be (collectively) appointed trustee would be an important element of the maintenance of such an institutionalised arrangement.

Accordingly, any individual incident or subsidiary set of incidents should also similarly be incapable of cession (e.g. the granting of a pledge or quasi-usufruct over the debt security). In other words, these individual incident-functionalities are, as part of the whole, subject to the particular restriction in question. Such a conclusion also aligns to, but ultimately also enhances the clarity of, the common law position (as confirmed in case law) on the *pactum de non cedendo*. Specifically, such an agreement "excludes not merely a transfer made with a view to the alienation of the right, but also cession *in securitatem debiti.*"[164]

Finally, any *supplemental* restrictions contained in the constitutive arrangement of company debt securities should probably be (rebuttably) presumed additional to, rather than in fulfilment of, the restriction envisioned in s 8.[165] This, no doubt, does not resolve all tension in these instances, but it must be put beyond the scope of this work to explore this particular matter any further (except to the extent that some of the principles outlined in the next section may be of ready application in this context).

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163 *Smuts v Booyens; Markplaas (Edms) Bpk v Booyens* 2001 (4) SA 15 (A) para [10].

This view is subjected to some debate and critique in Yeats et al *Commentary 2008* in the discussion from 2-879 to 2-891, but the work ultimately concludes at 2-891 that:

> "[i]n the *Smuts* case Cameron JA went so far as to hold that the statutory requirement that a private company must restrict the transferability of its shares [read: securities] required a company to restrict transfers in the 'full technical sense', which can be read as precluding private companies from only restricting a transfer of registered title. In so far as this was intended, the view is not supported, but as a ruling of the Supreme Court, it is a binding statement of the law, until it is overturned."

164 Van der Merwe et al *Contract* 407, citing in n 175 *Britz v Sniegocki* 1989 (4) SA 372 (D) 382-383 and *Trustees of the Insolvent Estate of Foley v Natal Bank* (1883) 4 NLR 26 (as additional persuasive authority). See also *Van Der Berg v Transkei Development Corporation* 1991 (4) SA 78 (Tk).

165 See specifically the approach advocated for in Yeats et al *Commentary 2008* 2-770 – 2-771.

8 3 2 Restrictions on the transferability of securities created by contract

The next question is whether the same can be said for non-company debt securities' internal features, where no public-private distinction is operative.

The answer lies in a secondary line of inquiry – to what extent is the constitutive function fulfilled by company memoranda in the creation and regulation of company securities analogous to that of the contractual arrangement creating those debt securities *not* issued by companies?

Whilst there are undeniable differences between memoranda of incorporation and contracts, both are a species of what English law would refer to as a broader class of "covenants". More importantly, both fulfil a constitutive function in the creation of securities.

Thus it should be asked whether the principles of the previous section can be applied without qualification to contractually constituted securities and, if not, to what extent certain isolated elements of the court's reasoning may be applied nonetheless.

As discussed above, there are two main underlying considerations that have bearing on the nature of restricted shares and the nature of those restrictions. The first consideration is that restrictions on private company securities hinge on the nature of the private company as legal entity.[166] This underlying rationale obviously cannot apply to non-company issued debt securities.

The second consideration is the binding effect of the memorandum amongst shareholders. Here a binding memorandum and a binding contract between security issuer and security holder(s) are of the same effect, enabling the application of a very similar argument, and it is submitted that the principles of restrictions on the transferability of company securities can be applied to non-company securities on this basis alone.

Like most, if not all, company debt securities, a non-company debt security is issued in terms of a contract; unlike company debt securities, there is no memorandum of incorporation exerting additional influence on the governance of the issuer-holder relationship (aptly illustrated by the fact that it is the memorandum, not the contract, which must contain restrictions on the transfer of company securities). A memorandum, as a species of covenant, can be said, among other things, to regulate a very complex set of relationships between a multitude of stakeholder interests in a commercial enterprise. The most striking result is that it has a majoritarian or democratic element not evidenced in the more binary terms of contracts in the narrower sense.

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[166] *Smuts v Booyens; Markplaas (Edms) Bpk v Booyens* 2001 (4) SA 15 (A) paras [8]-[9].

Contracts, though they may be multilateral, are more absolute in their functioning. There is little need to discount any interests other than those of the issuer and holder, and where there is such a need the law as it relates to contract suffices. In other words, any argument on the binding quality of a contractual term restricting the transfer of contractual rights needs no additional strengthening. Thus, a supporting argument that the nature of the issuer reinforces the absolute nature of the restriction becomes unnecessary. The *purely* contractual nature of the restriction, rooted in the foundational legal value of private autonomy,[167] is reason enough to assert its absoluteness in relation to the complex of rights and competencies it creates and governs.

Nonetheless there is one very important qualifier to this statement. It is the exception which proves the rule. Any purely contractual *pactum de non cedendo* is qualified by the fact that "the *prima facie* right…to deal freely" with one's rights (in this case securities) will *not* always "yield to contrary provisions ascertained on a correct construction" of the pactum.[168] This is an easily overlooked subtlety in the underlying principles of these *pacta* – agreements to this effect are only valid where the debtor has a legitimate interest in restricting the creditor's right to cede.

Right-holders are, as a point of departure, free to deal with their rights as they see fit.[169] However, the *pactum de non cedendo* (arising either at the time the right was created, or "at the time when the obligationary agreement preceding or accompanying the act of cession was concluded") is a recognised restriction on this right, itself also underscored by the deeper legal value of autonomy.[170]

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167 See Lubbe "Cession" in *LAWSA* § 164; and Van der Merwe et al *Contract* 406.

See also GF Lubbe "Estoppel, vertouensbeskerming en die struktuur van die Suid-Afrikaanse privaatreg" (1991) *Tydskrif vir die Suid-Afrikaanse Reg* 1 13-14 & n 97-111 for an excellent exposition of the principle of autonomy as a foundational element of legal policy informing horizontally operative legal rights and relationships.

Here it can be said that autonomy as value is made manifest in the law binding legal subjects by virtue of their mutual prior agreement to be bound, favouring the enforcement of a prior exercise of autonomy over any current desire to exercise autonomy in a conflicting manner.

168 As suggested in *Estate Milne v Donohoe Investments (Pty) Ltd* 1967 (2) SA 359 (A) 370F-G in the case of shares.

169 Lubbe "Cession" in *LAWSA* § 161 & n 1-2.

170 The power and effect of the value of individual autonomy to create and be held accountable to what has been agreed upon is reduced in the far more complex, and *multilateral*, constellation of competing interests inherent in the commercial juristic form.

This must surely to some degree have driven the statutory creation of a majoritarian dispensation in the memoranda of incorporation of companies. It is submitted that the role of the memorandum as a multilateral interest-discounting instrument is supported by the work of leading so-called theorists of the firm, specifically in the notion of a company as a "nexus of contracts" (see most importantly M Jensen & WH Meckling "The theory of the firm: managerial behavior, agency costs, and ownership structure" 3 (1976) *Journal of Finance and Economics* 305), and the coalescing of that nexus into a "firm as a co-ordinating third entity representing a contractual locus through which business is organised" (see H Hansmann & R Kraakman "Organizational law as asset partitioning" 44 (2000) *European Economic Review* 807 808-809). This is also briefly discussed in R Stevens & P de Beer "The duty of care and skill, and reckless trading: remedies in flux?" 28(2) (2016) *South African Mercantile Law Journal* 250 276-277 & n 142-143.

These restrictions by agreement may be outright or be conditional.[171] In this discussion, only *pacta* arising from a constitutive arrangement *creating* a security are of interest. In these cases:[172]

> "the restraint is a characteristic of the right itself. From its inception the right lacks the attribute of transmissibility. Since a cedent is unable to transfer a better title to another than his or her own, it ought to follow that any cession effected in defiance of the undertaking should be without legal effect…Yet…ever since *Paiges v Van Ryn Gold Mine Estates Ltd*, the approach has been that a contractual restraint cannot be enforced unless it served some or other functional purpose or interest of the party, be it debtor or cedent, in whose favour it was stipulated. The rationale seems to be that a restraint *per se* would tend to impede the free flow of commerce."

The approach of the *Paiges* dicta[173] appears to operate on the grounds that "a contractual restriction on the creditor's capacity to dispose of a right is contrary to public policy, unless justified by some legitimate interest on the part of the debtor".[174]

Yet a number of cases take a differentiated stance in instances where the restriction is an *intrinsic* one (i.e. was created alongside the right itself). Most notable is *Trust Bank of Africa Ltd v Standard Bank of SA*, in which the court stated (in an *obiter dictum*) that the principles relating to the validity requirement of a "functional purpose or interest of the party":[175]

> "do not, however, apply where the right is *created* with a restriction against alienation, and the restriction is contained in the very agreement recording the right, for in such a case the right itself is limited by the stipulation against alienation and can be relied upon by the debtor for whose benefit the stipulation was made."

Opponents of this view would rather that the distinction be scrapped in favour of a policy-aware inquiry into the legitimacy of the creditor's interest, including an element that examines the underlying reasons why the debtor opposes the transfer. This requires elevating the policy considerations at

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171 See *Jeffery v Pollak & Freemantle* 1938 AD 1; Lubbe "Cession" in *LAWSA* § 163 & n 13; as well as Van der Merwe et al *Contract* 407.

172 Lubbe "Cession" in *LAWSA* § 164. See further: *Paiges v Van Ryn Gold Mines Estates Ltd* 1920 AD 600 617; and *MTK Saagmeule* (*Pty*) *Ltd v Killyman Estates* (*Pty*) *Ltd* 1980 (3) SA 1 (A) 11. This is also supported by *Vawda v Vawda* 1980 (2) SA 341 (T); *Smuts v Booyens; Markplaas (Edms) Bpk v Booyens* 2001 (4) SA 15 (A); Van der Merwe et al *Contract* 406; GF Lubbe & CM Murray *Farlam & Hathaway: Contract – Cases, Materials and Commentary* 3 ed (1988) 654-656; and Yeats et al *Commentary 2008* 2-875 – 2-876.

173 *Paiges v Van Ryn Gold Mines Estates Ltd* 1920 AD 600 615-617.

174 Van der Merwe et al *Contract* 406 & n 165.

175 1968 3 SA 166 (A) 189 [own emphasis]. Similar views are found in *Britz v Sniegocki* 1989 (4) SA 372 (D) 382; *Italtrafo Sp A v Electricity Commission* 1978 (2) SA 705 (W) 711; and *Capespan* (*Pty*) *Ltd v Any Name 451* (*Pty*) *Ltd* 2008 (4) SA 510 (C).

play to form part of each dispute, and subsuming the legitimacy requirement into that broader policy-consideration discounting part of the inquiry.[176]

Which position is most appropriate in the context of debt securities?[177]

The most prominent, and perhaps in practice the only, non-company debt securities are those issued by government. By way of example, the (unsecured) RSA Inflation Linked Retail Savings Bond issued by the National Treasury, contains the following provision:

> "17. TRANSFER OF RETAIL SAVINGS BONDS
>
> 17.1. Retail Savings Bonds shall not be transferable and may not be sold or redeemed by the Investor, except in accordance with the provisions of clauses 11 and 13 above.
>
> 17.2. Registered Holders shall not be entitled to encumber or transfer any of their rights in the Retail Savings Bonds to any third parties, save that transfer to a third party shall be permitted in the event of the death of the Registered Holder and in accordance with the provisions of clause 18 below."

The scheme of the issue demonstrates a clear interest on the part of the borrower to restrict the transferability of these securities in § 3 ("Purpose and Objectives of the Issue), as being:

> "3.1. The purpose of the Issue is to raise funds to be utilised for the general purposes of the Government.
>
> 3.2. The main objectives of the issue inter alia are the following: 3.2.1. to create awareness amongst the general public of the importance to save; 3.2.2. to diversify the financial instruments on offer to the market; and 3.2.3. to target a different source of funding."

As a matter of government policy, the state-as-debtor has an undeniably defensible macroeconomic interest in denying the security-holders the right to transfer the security – namely increasing private saving through bond purchases.

In the majority of cases such a policy-aware inquiry into whether there is a "functional purpose" or legitimate "debtor's interest" is essentially moot, as any litigant will typically have little difficulty

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176 See notably D Hutchison "Agreements in restraint of cession: time for a new approach" (2016) 27(2) *Stellenbosch Law Review* 273, and Yeats et al *Commentary 2008* 2-876 – 2-878 & n 497-505 in support of the discussion. However, while giving an excellent treatment to the issue, the latter authority takes a (qualified) position *in favour of* the distinction in this context.

177 The point remains potentially unresolved and was not pronounced upon by the SCA in *Smuts v Booyens; Markplaas (Edms) Bpk v Booyens* 2001 (4) SA 15 (A); this is also noted in Lubbe "Cession" in *LAWSA* § 164 & n 9.

providing at least a precursory interest or function in such a restriction. Thus, the traditional formulation of the validity requirement, even if applicable to restrictions created at inception, is of little practical value as legal rule, and perhaps one could even go so far as to suggest that:[178]

> "would-be cessionaries who take cession without reasonable inquiry as to the existence and transferability of the subject matter of the proposed cession, do so at their own risk."

The preferred approach in this work is to retain the qualification – i.e. that this requirement only applies to *extrinsic* restrictions.

Finally, is the *extent* of any such restriction analogous to those that are in memoranda of companies and are applied to company securities, and thus of holistic, global effect? Subject to interpretive exceptions that may be found in specific agreements to restrict transferability, it seems so. It is fairly settled that such a *pactum* includes all forms of limited cession.[179] For this reason, it is submitted that the default position must be that a restriction includes transfer of both the security instrument and security asset, as well as any form of cession of an isolated incident-functionality or set of functionalities (e.g. in the case of a *quasi-usufruct* or cession *in securitatem debiti*), as described in Chapter 4.

8 4 Transmission of debt securities

The concept of transmission is currently understood to denote a change in *asset*-holdership in a manner other than transfer, and excludes the devolution of instrument- or security-holdership.[180] The *locus classicus* in this regard is the English decision of *Barton v London & North Western Railway Co*, where it was stated that:[181]

> "'transmission' appears to be used in contradistinction to 'transfer', and to include devolution by death, bankruptcy, marriage, and in any other way than by transfer."

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178 Van der Merwe et al *Contract* 406 & n 170, citing *Trust Bank of Africa Ltd v Standard Bank of SA* 1968 (3) SA 166 (A) generally.

179 Van der Merwe et al *Contract* 406 & 167-168.

There is also an excellent and detailed discussion of this issue, albeit in the context of company securities, in Yeats et al *Commentary 2008* 2-879 – 2-891.

180 This is the position taken in Blackman et al *Commentary* 5-371 and n 3 therein. Transfer is defined in § 7 above as:

> "the voluntary conveyance of the rights of a security-holder, as contained in a (pre-existing) security, from a person who wishes to cease to be, to a person who wishes to become, a holder of that security"

181 (1890) 24 QB 77 (CA) 88. See also Yeats et al *Commentary 2008* 2-857.

This, together with the definition of transfer offered at the start of this chapter, should make the essence of transmission quite clear – a change in holdership of the patrimonial essence of a security by operation of law. The key characteristic in the transmission of securities, thus, seems to be the fact there is no element of *legal* voluntariness in the transfer of the security asset.

Involuntary changes in ownership of things – i.e. change in ownership by operation of law – must be distinguished from cases where it is not desired by the disposing party, but the act in essence remains voluntary. This can be seen as *factual* voluntariness. The best example of these cases of *transfer* is a change in ownership in accordance with an order of court. Conversely, in the case of transmission, the disposing party may wish the change in ownership, but it will still occur by operation of law – the best example here is a merging of estates by marriage. These principles are easily applicable to asset-holdership in the securities context.

Thus, the list provided by the *Barton* case is highly instructive and it is hard to dispute that most cases revolve around death, insolvency, and marriage or civil union. However, it should not be seen as a closed list, and may include any change in asset-holdership occurring automatically through the operation of a legal principle that has been activated by a particular factual matrix.

Four important issues are most relevant in the present discussion. The first concerns transmission of certificated security-*assets* upon the death of an asset-holder. Under the South African law of succession:[182]

> "a beneficiary…never becomes owner of the inherited assets immediately upon the death of the deceased…Succession is thus itself not a mode of acquiring ownership. The most a beneficiary can obtain upon the death of the deceased (if vesting of rights has already occurred) is a claim (personal right) against the executor of the deceased estate. The content of the right is that, upon completion of the process of administration of the estate, the executor must transfer the bequeathed assets to the beneficiary. Only upon transfer of the assets (in the appropriate manner) will the beneficiary become owner of the assets.
>
> This naturally raises the question of who owns the assets of the estate in the period between the death of the of the deceased and the transfer of the assets to the beneficiaries."

This final question requires investigation, as the true complexity seemingly arises in the estate administration process. The position regarding the deceased estate is also useful in that it is generally representative of the most important dynamics of other cases of estate administration. In terms of the law of succession, once *dies cedit* has arrived, but before *dies venit*, the:[183]

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182 See MJ de Waal & MC Schoeman-Malan *Law of Succession* 5 ed (2015) 10-11.

183 *Van den Bergh v Coetzee* 2001 (4) SA 93 (T) 95.

"executor does not step into the shoes of the deceased on his death; he does not succeed to the person of the deceased. He is simply required to administer and distribute his estate…"

The most authoritative, and useful, view on the deeper legal position is that "the executor of the deceased estate is the owner of the assets in his or her official capacity during the period of the administration of the estate…".[184] This implies that the executor or administrator of the estate must become asset-holder, albeit *nomine officii*, until the discharging of the obligation to transfer asset-holdership to the appropriate beneficiary. As will be shown below, that is indeed the position with respect to *instrument*-holdership. Unfortunately, neither the exact nature of a deceased estate nor the nature of the executor nor administrator's relationship to it are clear, so that no definitive answer regarding transmission of the security asset can be given.

All that might be said in this regard is that it cannot be accepted that the security asset is, for the duration of the administration of the estate, a *res nullius*. It is also, as previously mentioned, not regarded as the property of the appropriate beneficiary during this period. As a result, despite not enjoying widespread acceptance, the "ownership *nomine officii*" construct provides the most reasonable and practicable set of legal outcomes.

For this reason, it is submitted that upon the death of the deceased the security asset is *transmitted* to the executor or administrator in her official capacity until she duly transfers the asset to the appropriate beneficiary. Accordingly, this is to be regarded as a unique form of holdership (i.e. "ownership") of the patrimonial substance of the security (or, where there is more than one executor or administrator, co-holdership). This also makes clear the position of the instrument-holder at the time of the death of the asset-holder. Until the executor or administrator also becomes instrument-holder *nominee officii* (see below), the principles of the *sui generis* agency of the instrument-holder must apply, and her duties of representation must automatically become effective against the nominal asset-holder upon transmission of the asset.

This also appears to accord with historical best practice as evidenced by the model memorandum provided in *Table B* of Schedule 1 of the 1973 Companies Act (neither forms *CoR15.1A* nor *CoR15.1B* associated with the 2008 Act suggest terms in this regard), which provided as follows:

"16. The executor of the estate of a deceased sole holder of a share shall be the only person recognised by the company as having any title to the share. In the case of a share registered in the names of two or more holders, the survivors or survivor, or the executor of the deceased survivor shall be the only persons recognised by the company as having any title to the share.

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[184] De Waal & Schoeman-Malan *Succession* 11 & n 87. See also Yeats et al *Commentary 2008* 2-857 – 2-858.

> 17. Any person becoming entitled to a share in consequence of the death or insolvency of a member shall, upon such evidence being produced as may from time to time be required by the directors, have the right, either to be registered as a member in respect of the share or instead of being registered himself, to make such transfer of the share as the deceased or insolvent could have made, but the directors shall, in either case, have the same right to decline or suspend registration as they would have had in the case of a transfer of the share by the deceased or insolvent before the death or insolvency.
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> 18. The parent or guardian of a minor and the *curator bonis* of a lunatic member and any person becoming entitled to shares in consequence of the death or insolvency of any member or the marriage of any female member or by any lawful means other than by transfer in accordance with these articles, may, upon producing such evidence as sustains the character in which he proposes to act under this article, or of his title, as the directors think sufficient, transfer those shares to himself or any other person, subject to the articles as to transfer hereinbefore contained.
>
> *This article is hereinafter referred to as the 'transmission clause'.*
>
> 19. A person becoming entitled to a share by reason of the death or insolvency of the holder shall be entitled to the same dividends and other advantages to which he would be entitled if he were the registered holder of the share, except that he shall not, before being registered as a member in respect of the share, be entitled in respect of it to exercise any right conferred by membership in relation to meetings of the company."

It seems clear that the intent of the above is to deal with the issue of a change in asset-holdership by operation of law despite no formal change in instrument-holdership. This appears to be confirmed in clause 19 (the "transmission clause") in its providing for benefits "to which he would be entitled *if he were the registered holder* of the share".

A key issue in this section, however, is the position with respect to the security *instrument*. Here it should be considered whether it is settled that transmission can only, as per the view of Blackman et al,[185] apply to changes in asset-holdership and that it does not extend to changes in instrument-holdership. Again the most illustrative example, yielding principles of wider application, is the death of a nominee instrument-holder. In the absence of express alternate arrangements, would the death of an instrument-holder cause holdership of the security instrument to pass by operation of law to an heir?

Both the 1926 and 1973 Companies Acts enabled the use of nominees in the same manner, best expressed by s 104 of the latter:

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185 Blackman et al *Commentary* 5-371 n 3. This is also broadly supported in Yeats et al *Commentary 2008*, specifically 2-859 – 2-860 with an excellent treatment of relevant domestic and foreign case law and analysis from 2-860 – 2865.

> "A company shall not be bound to see to the execution of any trust, whether express, implied or constructive in respect of any share."

This has been taken to have meant that a company was barred from registering any person acting in a representative capacity on its register. The important exception, however, was persons authorised to act *nomine officii*, as per s 103(3) of the Act:

> "A company shall, subject to the provisions of its articles, enter into the register as a member, *nomine officii*, of the company, the name of any person who submits proof of his appointment as the executor, administrator, trustee, curator, or guardian in respect of the estate of a deceased member of the company or of a member whose estate has been sequestrated or of a member who is otherwise under disability or as the liquidator of any body corporate in the course of being wound up which is a member of the company, and any person whose name has been so entered, in the register shall for the purposes of this Act be deemed to be a member of a company."

Whether the broader position that an executor or administrator of a deceased estate "owns" the assets of the estate *nomine officii* is ultimately correct or not, this provision provided a statutory basis for the legal position regarding, at least, instrument-holdership of shares. Section 56 of the current Companies Act appears to have a similar import – the executor may, upon presentation of her authority, be entered into the register and is therefore the instrument-holder *nomine officii*.

This narrows the issue down to what the position is between the death of the deceased and the registration of the executor or administrator as *nomine officii* instrument-holder or in cases where no such registration occurs. In Chapter 4, it was shown: (1) that the security instrument is a legal object capable of holdership and cession because it has extra-juridical usefulness; but also (2) that it is not a *patrimonial* object. By its definition it is what remains where the patrimony (derived from the collective entitlements of enjoyment) of the underlying interest resides elsewhere in the security asset.[186]

This provides a clearer understanding. The definition of an estate is the sum of the assets and liabilities, and the security instrument is a non-patrimonial object – thus it is incapable of being viewed as an asset. The relevant principles of the law of succession are only applicable to assets. As the instrument is not an asset, those elements of legal framework of succession are simply not applicable. The security instrument *does not and cannot devolve*. It follows that the security-instrument must, on instruction from the asset-holder to the executor or administrator of that estate, be transferred to the former's chosen successor. This is also in line with the applicable provisions of the Companies Acts past and present.

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186 § 4 3 2 1.

Although this will not happen often, the nature of instrument holdership means there is in fact no reason a security cannot, for a short period of time, have no instrument-holder. Its patrimonial substance remains owned (it is not a *res nullius*), but that substance simply cannot be *realised or enforced* until a new instrument-holder is entered onto the register. A similar position, to further illustrate the defensibility of this argument, exists in the time between a court order being handed down to rectify a company register and the time the register is rectified – could one say that during that time the underlying complex of rights and competencies are enforceable? The company could not recognise either the registered holder (due to the court order), nor the person in whose favour it is granted (it may only recognise the person on the register). One may even go so far as to say that in this very short period of time the obligations (and other private law relationships) are temporarily *natural*, rather than civil, in nature. Another example is the factual scenario found in *Brink and Others v Mampudi Mining (Pty) Ltd*[187] – registration in the name of a person or trust that does not exist.

In *Lurie v Sacks and Another*[188] the court held that a provision in a company's articles of association stating "until transfer has been effected [a person entitled to a share should] be entitled to the same dividends and advantages to which he would be entitled if he were the registered holder of the shares" did not cause the executors of the deceased shareholder's estate to be entitled to attend and act at company meetings until they were duly entered *nomine officii* on the company share register.[189] Presumably, in line with the transmission clause under the 1973 Act, this ensured the passing of benefits while prohibiting the exercise of other competencies as conferred by holdership of the asset and instrument.

Nonetheless, the authors in *Commentary 2008* argue that "on balance, the authorities favour references to a 'shareholder' in the memorandum of incorporation being read as including the estate of a deceased holder of securities with the estate being regarding as *a metaphorical member* prior

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187 2003 (5) SA 221 (T), where the court held there was not sufficient cause to rectify the register.

188 1972 (2) SA 396 (O).

189 Article 18 of Table A in Schedule 1 to the Companies Act of 1973 contained the following:

> "18. A person becoming entitled to a share by reason of the death or insolvency of the holder shall be entitled to the same dividends and other advantages to which he would be entitled if he were the registered holder of the share, except that he shall not, before being registered as a member in respect of the share, be entitled in respect of it to exercise any right conferred by membership in relation to meetings of the company.

Article 19 effectively replicated the wording of s 103(3) of that Act, and the latter stated:

> "A company shall, subject to the provisions of its articles, enter in the register as a member, *nomine officii*, the name of any person who submits proof of his appointment as the executor, administrator, trustee, curator or guardian in respect of the estate of a deceased member of the company or of a member who is otherwise under disability or as the liquidator of any body corporate in the course of being wound up which is a member of the company, and any person whose name has been so entered in the register shall for the purposes of the Act be deemed to be member of the company."

A Milne (ed), C Nathan, K Lamont Smith & P Meskin *Henochsberg on the Companies Act* 3 ed (1975) further remark regarding article 18 in light of the *Lurie* judgement at 789 that "[i]t is doubtful whether, in the absence of any provision specifically giving the right to vote, a person is entitled by transmission but not registered as a member is entitled to vote in virtue of this article."

to the executor becoming a de facto member by way of registration". The authors support the notion of "metaphorical membership", which should really rather be expressed as *putative instrument-holdership* under the 2008 Act, by noting that from a policy (and presumably practical) perspective this is a sensible manner in which to approach the state of affairs.[190]

While the argument is persuasive, it requires an examination into the construct and nature of executorship that is beyond the scope of this work. It is suggested, however, that a basis for recognition of a putative instrument-holdership may be found in the statement by the court in *Van den Bergh v Coetzee* that "the executor does not step into the shoes of the deceased; he does not succeed to the person of the deceased. He is simply required to administer and distribute his estate…"[191] What the statement seems to evince is that at the core of the nature of executorship, whatever its legal form, is an ability to enable the executor to administer the estate of the deceased, and it appears quite plausible that a putative instrument-holdership should be recognised as a necessary component of that ability.

On the same basis – i.e. that an *estate* excludes non-patrimonial legal objects – it can be argued that this conclusion applies *mutatis mutandis* to curators or trustees of insolvent estates of instrument-holding persons.[192] There is no loss of instrument-holdership in these cases, but the person able to exercise the incidents that come with instrument-holdership is nonetheless also no longer the person named on the register. The merging of estates by marriage or civil union could also abide by this rule. If a *security*-holder's estate is merged, instrument-holdership simply becomes instrument-holdership – as a *sui generis* form of agency – for the security asset *as patrimony in the new, merged estate*. If a mere instrument-holder's estate is merged there is no transmission of security-instrument, as it has been shown to be out of scope of the estate per se (this must not be confused with the merger of *legal entities* as specifically regulated by the Companies Act). The same position probably could not apply to liquidations, as the legal subjectivity of a juristic instrument-holder in liquidation does not come to an end or change hands in a similar manner, and arrangements for a new instrument-holder would naturally occur during the process of winding down.

The third issue to be dealt with in context is the transmission of uncertificated securities. In dealing with the changing of "ownership" of securities, the FMA relies on s 53 of the Companies Act of 2008. Transmission is dealt with specifically in s 53(6) and also in s 38(1)(c) of the FMA; though similar, the latter is the more comprehensive formulation providing:

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190 Yeats et al *Commentary 2008* 2-863 – 2-864 [own emphasis].

191 2001 (4) SA 93 (T) 95.

192 With Yeats et al *Commentary 2008* 2-865 in support.

> "Nothing in this section prejudices any power of a participant or central securities depository, as the case may be, to effect a transfer to a person to whom the right to any uncertificated securities or an interest in uncertificated securities referred to in paragraph has been transmitted by operation of law."

This would appear to mean that where a person has furnished a CSD or CSDP with sufficient proof that the transmission of asset-holdership has indeed taken place, a register entry must be effected to give effect to the transmission. The instrument-holder in question will simply be regarded as the *sui generis* agent of the (new) owner by transmission from the time the transmission was legally effective. Because, as shown above, instrument-holdership is not an asset and cannot devolve, there can be no transmission of an instrument-holder. This also means that where an instrument-holder is a natural person, the underlying complex of rights and other competencies of security may be briefly unenforceable in the case of her death or in cases of a less final loss of legal capacity.

The fourth issue is the matter of interests in securities (dealt with more fully in the section which follows). This issue can also be put to rest with relative ease. The transmission of these limited real interests (i.e. isolated incident functionalities of securities) appear to be no different to transmission of the entirety of the security asset. Interests in securities are *real* in nature, they are *patrimonial*, and their real effect is rooted, factually, in the holders' *effective control* over the instrument-holder. This effectively means that transfer and transmission of these interests can be dealt with on the same basis as the transmission of asset-holdership itself. The sole exception, of course, could be the possibility of the granting of a personal servitude – this is dealt with in Chapter 9.

It naturally remains open for any provision in the constitutive arrangement of a security (including not only acquiring contracts or similarly constitutive contractual instruments, but also where appropriate the memorandum of incorporation of the issuer) to deal with these matters differently. The only proviso is that the provisions are permissible in terms of general law and not *contra bonos mores*. An example of a provision incompatible with general law would be a provision that provides for the transmission (upon the death of the security-, asset-, or instrument-holder) of the ability to compel the company to pay dividends to a third party who is not the executor of the estate, but without bestowing on her instrument-holdership. This would amount to the acquisition of rights as against the company in respect of dividends, but ultimately contravenes the correct reading of s 37(9) of the Companies Act of 2008, making the provision unlawful. However, a similar bestowal of the right to receive the ultimate patrimonial substance of the dividends in own capacity would not – it would merely amount to the bestowal of a limited real right enforceable against the instrument-holder (again, as per the principles outlined in Chapter 9).

CHAPTER 9

9 Limited (real) interests in securities

It was established in Chapter 4 that securities' incident-functionalities may serve as legal objects to (the creation of) secondary rights on three levels. There may be (lawful) *holdership* of: (1) the security; (2) the asset or instrument on its own; or (3) any of the more specific incident-functionalities that can be isolated from within the underlying interest. It was further noted that on the level of incidents, individual incident-functionalities of a security are not necessarily or always legal objects. Instead, they are made so, dynamically, by the specific exercise of legal subjectivity through holding an element or elements of the broader subjective rights (and relationships) content of the security.[1] In other words it is more accurate to state that they are *capable of functioning as*, *rather than* ab initio *are*, legal objects.

It is fairly trite that in the case of corporeals, the ability to grant secondary limited real rights is a function of bestowing physical control over the object upon the acquirer of such a right together with the requisite kind of *animus*. The former is traditionally referred to as possession according to the majority of property law authorities, but has been reconceptualised as effective control by Van der Walt. It is simple to understand, for instance, in the case of a right of use of a car – the keys to the car coupled with access to the car provides effective physical control, such that together with the correct corresponding intentions, a real right is effectively constituted.

It can generally (but not always)[2] be accepted that only one person can have effective control, or possession, of a corporeal thing at any given moment.[3] In this regard, a key doctrinal challenge

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[1] See § 4 1 and § 4 3 2. A good example would be the act of granting a usufruct.

[2] See AJ van der Walt & GJ Pienaar *Introduction to the Law of Property* 6 ed (2009) § 13.3.5, 191.

[3] See also Chapter 4, § 4 3 2.

posed by incorporeals in general, at the level of rights, is that this does not seem to be the case. Rather, it seems that different persons are able to establish effective control, simultaneously, over different elements of the security as objects of that control.[4] This could facilitate the establishment of multiple limited proprietary relationships of holdership – i.e. limited real rights – that are simultaneously exercisable, which is ostensibly not true of corporeals.

The outcomes of Chapter 4, specifically in § 4 3 2, outlining *effective factual control* as control of the instrument-holder held in relation to a specific legal object, assists greatly with this issue. Effective factual control of an incorporeal, coupled with the correct form of intention, gives one *effective control* – a functionally superior construct to the "*drogbegrip*"[5] of *quasi-possessio*. Factual control may manifest lawfully as a facet of the agency implicit in instrument-holdership, or unlawfully as mere control over the instrument-holder *sine iusta causa*. It may be exercised over the security asset (as object) *or* subsidiary and more limited legal objects created from the content of that asset. Most importantly, effective control may be exercised in this manner over different elements of a security *simultaneously*.

However, crucially, effective control over a specific incident-functionality rising from, for example, a security *cannot* be held simultaneously by two people – i.e. simultaneous control over a personal right is possible, but simultaneous control over a specific legal object gleaned from that right (at the level of incidents) is not possible. This is the key to grasping how various contemporary yet effective proprietary interests in securities – i.e. limited real rights – may be established.

9 1 Real security – cession *in securitatem debiti*

In this section it is neither necessary nor appropriate to outline, discuss, and evaluate all the salient legal principles relating to: mortgages in the broader sense, pledge as a species of mortgage,[6] or even cession in *securitatem debiti* of ordinary obligations. These areas of law enjoy a rich and deep wealth of judicial and academic analysis, and they do not require any wholesale re-evaluation within the context of this work. All that is required here is a discussion of the application of the principles of Chapters 4 and 5 to those legal rules and principles that are relevant to the cession *in securitatem*

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4 However, see Chapter 4, § 4 3 2 2.

5 "Sham concept" – as per GF Lubbe "Sessie in securitatem debiti en die komponente van die skuldeisersbelang" (1989) 52 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 490 492 n 42.

6 See for instance PJ Badenhorst, JM Pienaar, H Mostert & M Van Rooyen *The Law of Property* 4 ed (2004) § 16.1, 357.

debiti of *securities*. In that regard, also, the work of Chapter 4 (and specifically in § 4 3 2) need not be repeated or summarised here – it will merely be drawn upon as required.

9 1 1 Certificated securities

There are two kinds of cession *in securitatem debiti.* The first is the so-called "out and out" cession of an obligation to secure a debt (typically with an agreement to reverse the cession once the principal debt is extinguished without the event of default). This is also referred to as a "fiduciary cession" (a type of *pactum cum fiduciae*), wherein the creditor agrees to re-cede the obligation to the debtor once repayment of the principal debt has occurred.[7] It may take the form of an out-and-out transfer of security-holdership as a whole, or the transfer of asset-holdership only, as both will broadly have the same economic and legal effect. There is nothing contentious about this kind of security cession and the applicable legal principles are clear when read with the discussion of the transfer of securities in Chapter 8, and will not be dealt with further.

The second construction is a limited cession styled as the *pledge* of a moveable, incorporeal thing. The focus of this section will be on this pledge of a debt security *in securitatem debiti*. Thus, in this section and the next the term "cession *in securitatem debiti*" must be taken to refer to the pledge construction of the cession (unless the context indicates otherwise).

In the generic construction of the pledge *in securitatem debiti*, the real right is bestowed on the pledgee by a limited cession of a specific component of the creditor's interest – the entitlement of determination (*beskikkingsbevoegdheid*). This effectively isolates the pledge-object from further acts of determination (most often disposition) by the pledgor and provides the pledgee with the kind of control required to be able to realise the economic object underlying the pledge.[8]

The potential problem with the use of this generic construction is that the underlying juridical principles which support this construction are the same principles which, in Chapter 4, enabled securities to be viewed as comprising of a security asset and instrument respectively. Yet, as a result of the fact that the entitlement of determination over the security's total underlying interest resides, already isolated, within the security instrument, it cannot be "ceded out of" that instrument *in*

[7] See for instance Badenhorst et al *Property* § 16.8; MS Blackman, RD Jooste, GK Everingham, JL Yeats, FHI Cassim & R de la Harpe *Commentary on the Companies Act: Volume 1* (RD 8 2011) § 133, 5-365 & n 4 and 5-368 & n 1 (and numerous authorities cited therein); GF Lubbe (revised by TF Scott) "Mortgage and Pledge" in WA Joubert et al Law of South Africa Vol 17(2) (2 ed) 2008 § 180; or SWJ Van der Merwe, LF Van Huyssteen, MFB Reinecke & GF Lubbe *Contract: General Principles* 4 ed (2012) 425 & n 322.

[8] See also Chapter 4, § 4 1 1.

securitatem debiti. How then to effect the pledge of a debt security in a manner that creates a concrete limited real right in similar fashion?

The answer lies in returning to first principles. In what is regarded in this work as the most authoritative, and accurate, statement on the nature of the pledge *in securitatem debiti*, a number of guiding principles are found in respect of the real agreement:[9]

> "*dat nakoming daarvan* [i.e. cession of the *beskikkingsbevoegdheid*] *'n sekere mate van heerskappy oor die sekuriteitvoorwerp vir die sekerheidsnemer bewerkstellig. Sodoende word die sekuriteitsvoorwerp teen verdere beskikkingshandelinge deur die sekuriteitsgewer geïsoleer…Inderdaad is dit juis die element van feitelik-juridiese heerskappy wat, tesame met die publisiteitsfaktor, die jurdiese erkenning van die sekerheidsnemer se belang as 'n saaklike reg veranker en regverdig…Dit bring onder meer mee dat die* vereistes vir beheer in enige geval afhang van en bepaal word deur die geaardheid en eienskappe van die sekerheidsvoorwerp."

This provides three core principles. First, the real agreement must effect a certain measure of control for the pledgee over the economic object underlying the pledge (the "*sekuriteitsvoorwerp*"). Second, the measure of control must be sufficient to "isolate" that pledge object against further dispositive acts ("*beskikkingshandelinge*") by the pledgor. This protection of the pledge object facilitates the juridical recognition, or concretisation, of the real right. Third, the nature and characteristics of the pledge object in question will be determinative of the requirements for the mastery ("*heerskappy*"), or perhaps rather control, necessary to establish this particular real right.

These principles, thus, are of general use in understanding the deeper theoretical implications of the final acceptance of the pledge construction into South African law. *Leyds v Noord-Westelike Koöperatiewe Landboumaatskappy Bpk*[10] is generally regarded as the watershed decision that cemented judicial acceptance of the pledge construction. Thereafter *Grobler v Oosthuizen* went further, confirming that pledge is in fact the default construction of a security cession.[11] Yet the courts have not yet chosen explicitly to explain its underlying nature. This, it is submitted, does not matter, as: (1) the pledge *in securitatem debiti* is part of South African law; and (2) Lubbe's submissions on the nature of that pledge represents, by some margin, the most convincing and practically coherent approach to the nature of the construction.

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9 Lubbe (1989) *THRHR* 491. See also GF Lubbe "Cession" in WA Joubert et al *Law of South Africa* Vol 3 (3 ed) 2013 § 180 n 19; GF Lubbe "Die verpanding van vorderingsregte en die regsdogmatiek - *quo vadis*?" (1991) 2 *Stellenbosch Law Review* 131 145; and Van der Merwe et al *Contract* 430 & 366.

10 1985 (2) SA 769 (A).

11 2009 (5) SA 500 (SCA) [24]. See also Lubbe "Mortgage & Pledge" in *LAWSA* § 180; Badenhorst et al *Property* § 16.8.1, 396-399; and Blackman et al *Commentary* § 133, 5-368 n 1 ("Pledge now the default").

Adherence to these three principles makes it possible to arrive at a sound *and practical* construction of the pledge of securities, though one that differs slightly from the generic construction.

To arrive at such a construction, one must re-examine the principle of the provision of mastery ("*heerskappy*") as articulated above. This is said to hinge on the nature of the pledge object and thus the discussion must begin with a proper understanding of that object.

From the broader field of mortgage and pledge it seems that the content of the right of pledge is typically described as the entitlement to sell in execution the property which has been pledged (or to share preferentially in the proceeds of its sale in attachment or insolvency, if applicable).[12] It is further clear that this is a conditional entitlement, as it must be in a sense *activated* by the pledgor's inability to settle the secured principal debt. As such the pledge object is clear – the thing itself.

However, the pledge object is described differently in the pledging of (obligationary) *incorporeals*. In this regard, the following point of departure is particularly useful:[13]

> "The conceptual nature of the pledge construction has not been fully developed by the courts. Such indications as there are, however, suggest that the pledge of incorporeals is based on the idea of a limited cession to the cessionary of a particular component of the cedent's interest in the performance due from the debtor, namely 'the exclusive right to claim and receive…the amounts owing'…Such a limited cession invests the cessionary with control over the economic value inherent in the debtor's performance, and as such it provides a basis for the recognition of a real right of pledge in favour of the cessionary…*Strictly speaking, the real right exists in respect of the proceeds of performance due from the debtor, rather than in respect of the personal right itself.*"

Here the legal object of the pledge *in securitatem debiti* is described as the economic value of the *result* of the performance contemplated ("the proceeds of performance"), not the personal right itself. This is also in keeping with the manner in which this work defines a legal object as anything which can be said to have legal value by virtue of its *extra-juridical usefulness*.[14] This also helps distinguish the legal object itself from the *content* (or entitlement) of the right, as the latter circumscribes what the legal subject as right-holder is enabled to do with respect to the former – i.e. realise the value of that object in execution.

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12 Badenhorst et al *Property* § 16.1, 358; Blackman et al *Commentary* § 133, 5-366 – 5-367 (including a multitude of authorities cited in n 1 on 5-367); GF Lubbe (revised by TF Scott) "Mortgage and Pledge" in WA Joubert et al Law of South Africa Vol 17(2) (2 ed) 2008 § 179; CG Van der Merwe *Sakereg* (1979) 470-471; and Van der Merwe et al *Contract* 429-430.

13 Van der Merwe et al *Contract* 431-432 [own emphasis]. As an aside, the quoted portion describes the *beskikkingsbevoegdheid* as the ability to "claim and receive…the amounts owing", but one should take it to refer, more precisely, to the ability to claim and receive the *benefits of performance,* as it is trite that performance does not necessarily have to take the form of payment of a sum of money.

14 See Chapter 4, § 4 3 2 1.

To relate this understanding of the legal object to the pledge of securities, consider as a point of departure the description of the pledge of *shares* by Blackman et al:[15]

> "Where the shareholder pledges his rights, the '*dominium*' or 'bare ownership' in the rights pledged remain vested in him (the cedent) – just as the rights of ownership remain vested in the pledgor of corporeal movable property. This '*dominium*' is said to be a 'reversionary interest' which, by operation of law, causes the pledged rights to be re-ceded to the cedent (pledgor) upon repayment of the indebtedness (and is based on the cedent's interest in the debtor's performance and is not a claim in contract for re-cession). The *dominium* is an attachable right, and on the insolvency of the cedent it entitles the trustee of his estate to control the realisation of the pledged asset. It has a money value, and can itself be ceded, and even pledged *in securitatem debiti.*
>
> The cessionary (pledgee) acquires a restricted 'real' right to the pledged right, *which* (absent the intervention of the cedent's insolvency) *entitles the cessionary to the exclusive right to enforce the ceded right, a right which he may exercise in the event of non-payment of the principal debt*. If there remains a balance after the principal debt has been paid, the cedent can, on the ground of his reversionary interest, claim it."

Here, one observes a subtle return to a more traditional and proprietary description of pledge, which is unsurprising given the observation that securities are often treated as more proprietary than their obligationary nature technically accounts for. Nonetheless, one must arrive at an understanding which describes the pledge object in terms of the value of the result of performance, rather than merely borrowing vague terms such as "reversionary interest" from property law.

This begins with the manner in which the courts have generally treated the concept of the "reversionary interest" in the context of pledge *in securitatem debiti*. In this regard, the dictum of *Grobler v Oosthuizen* is most useful:[16]

> "With regard to the meaning of this concept [the court a quo] referred to the following statement in *Incledon (Welkom) (Pty) Ltd v Qwa-Qwa Development Corporation Ltd*…:
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>> 'When the company executed the [cession *in securitatem debiti*] it thus retained the ownership of its rights against the [principal debtor]…That ownership, as appears from the authorities, consists in a *reversionary interest which entitled the owner (cedent) to claim the re-cession of the rights upon payment of the indebtedness*.' [My emphasis.]
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> In the light of this statement the full court understood…[the] reversionary interest to lie in a claim for re-cession of the policies…

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15 Blackman et al *Commentary* § 133, 5-366 – 5-367 [own emphasis].

16 2009 (5) SA 500 (SCA) [19]-[22].

> The question is, however, whether that statement constitutes good authority. With respect, I think not. First, I believe it would simply amount to a recapitulation of the outright cession-*cum-pactum fiduciae*-theory…Secondly, it is, in my view, in direct conflict with those decisions which held that a claim ceded *in securitatem debiti* automatically reverts to the cedent once the secured debt is extinguished. …Scott…explains the reasoning behind these decisions as follows, with reference to the analogy of a pledge:
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> > 'The accessory nature of pledge has the effect that on the discharge of the principal debt, the right of pledge is automatically extinguished. In the case of a pledge of corporeals the pledgee is, after the extinction of the right of pledge, still in possession of the pledged article, which he must then hand over to the pledgor. In the case of a pledge of incorporeals where only the power to realise the right is transferred, this power reverts to the pledgor automatically rendering it unnecessary for the pledgee to re-cede it to him.'
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> …
>
> As to the real meaning of the cedent's 'reversionary interest', I can do no better than to refer to the following explanation by Nienaber JA in *Development Bank of Southern Africa Ltd v Van Rensburg*…with which I respectfully agree:
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> > 'This reversionary interest, properly understood, refers to the cedent's interest in the debtor's performance (i.e. satisfaction of the principal debt by the debtor) rather than to his interest in the cessionary's performance (i.e. re-cession of the principal debt on satisfaction of the secured debt – which is [or would be] a right *ex contractu* against the cessionary).'"

With this as background, it seems eminently sensible to construct a *generic* pledge *in securitatem debiti* around the limited cession of the entitlement of determination (*beskikkingsbevoegdheid*) of the pledged right. First, this provides the pledgee *access to and control over* the as-yet-unrealised economic value of the performance upon a default event – i.e. it provides what was quoted with approval in *Grobler* above as the "power to realise the right".[17] Second, by leaving a "nude" entitlement of enjoyment (*genotsbevoegdheid*) with the pledgor, it concretises the notion of the reversionary interest as the "cedent's [patrimonial] interest in the debtor's performance".

Yet debt securities represent a far more complex conglomerate of underlying obligations *and* other competencies in comparison to standard obligations. What does that mean in terms of coming to an accurate description of the pledge object?

Four salient characteristics of securities are a helpful starting point in formulating this description. First is the nature of the patrimonial substance of a security. It is holdership of a *claim or set of claims* to future performance or performances, holdership of which provides the holder with patrimonial

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[17] S Scott *The Law of Cession* 2 ed (1991) § 12.2.1.3.

value approximating the discounted future value of the performance or performances in question.[18] This implies that the *patrimonial value* of debt securities is variable in specific ways and also that the value of a debt security is determined by more than just its terms of repayment.

From the above typological features, as well as the nature of the underlying substance of the security, the economic worth of a debt security is not only a function of the terms of its discounted future cash flow, but also of the *relative value* of its pay-out compared to others in the prevailing macro-economic environment. Sometimes the sum of a debt security's future discounted cash flow is very similar to its market price and thus its asset value. However, external macro-economic variables may, and most often do, influence the market price of a debt security by making it a more or less desirable asset in a particular interest rate environment. Primarily, differences between the interest rate offered by the security and similar-term prevailing market interest rates create opportunities for interest rate arbitrage, causing some fluctuations in the value of a given debt security despite a stable and predictable cash flow. Secondarily, the economic health of the issuer (borrower) may also influence its price irrespective of its coupon structure, as it impacts the default risk associated with that security.

Second, functioning as a holistic complex of underlying rights and other competencies, securities can be described as having an enhanced proprietary character, so that in some cases the law appears to reify securities more than their obligationary nature technically accounts for.[19] This has much to do with the unique interrelation between the underlying structure of securities and their economic functions, as has evolved over time.

Third, publicity is a more important feature of policy in the conclusion of juristic acts where securities are concerned than seems to be the case for personal rights in general.[20]

Fourth, among the prominent typological features of a security are that:[21]

> "1 2 one of its primary functions for the holder is 'investment' – i.e. the realisation of a net patrimonial gain flowing from claims to the performance tenderable in the context of the overall financial arrangement ["investment"];
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> 1 3 performance is intended to be tendered over time at one or more certain or ascertainable future dates, rather than only immediately ["deferral"]…"

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18 Chapter 4, § 4 1 1.

19 Chapter 4, § 4 1 3 and most importantly § 4 3 2.

20 See Chapter 4, § 4 3 2 2.

21 Chapter 6, § 6 3 3 1.

As was shown throughout Chapter 4, asset-holdership (or security-holdership) provides access to a multitude of potential *functionalities* of the entitlement of enjoyment ("*genotsbevoegdheid*").[22] What is required to juridically objectify such an incident-functionality (or set of incident-functionalities) *is a particular exercise of legal subjectivity* over it. It was also suggested that this is the basis for the creation of a limited real right with such an incident or set of incidents as its legal object. It was further shown that, unlike the general principles applicable to corporeal things, different incidents of a security may be simultaneously held by various parties.[23] This notion of different elements of value distilled from the entitlement of enjoyment, and individually subjected to pledge, is in fact also at least acknowledged by a number of tangential propositions found in various existing authorities.[24]

Thus one must find a principle by which not only the holistic value of the complex of performances envisaged by a security, but also subsidiary individual elements of economic value, can be pledged in accordance with the existing doctrinal principles relating to the pledge *in securitatem debiti.*

This far more nuanced view of: (1) the nature of the underlying interest; and (2) the variability of the nature of potential legal objects which may be pledged in relation to securities must now be subjected to Lubbe's first principles of the pledge of incorporeals. Those principles require that the object of pledge (i.e. the incident-functionality or set of functionalities determined by the parties as those elements of patrimonial value which must function as real security) must be "isolated" from future acts of disposition by the pledgor. This is to be done by providing the pledgee "*feitelik-juridiese heerskappy wat, tesame met die publisiteitsfaktor, die jurdiese erkenning van die sekerheidsnemer se belang as 'n saaklike reg veranker en regverdig*."[25]

For securities it has already been proposed that:[26]

> "[the functional equivalent of] physical control in the realm of corporeals takes the form of *effective factual control over the instrument-holder*, which when coupled with the necessary mental element(s) of control

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22 A useful, though not exhaustive, list can be found in Lubbe "Cession" in LAWSA § 180 in n 19:

> "A claim, so it is reasoned, confers on the holder of the right not only the capacity and hence the locus standi to exact performance (to collect interest, in the case of a money debt, and capital once the claim has matured) but also a variety of other functions, such as the capacity to alienate, waive, novate or renew it, to cancel the transaction giving rise to it, to vote or claim a preference where the right carries such a privilege, to apply for the debtor's sequestration, to take advantage of a lien or suretyship, and so forth."

23 See Chapter 4, § 4 1 1 and § 4 3 2 1. This is not to say that the *same* incident-functionality may be simultaneously and separately held – the *nemo plus iuris ad alium transferre potest quam ipse habet* principle will still always apply to any specific and individualised held interest.

24 For instance: in Blackman et al *Commentary* § 133, 5-366 – 5-367 it is noted that "The *dominium* is an attachable right, and on the insolvency of the cedent it entitles the trustee of his estate to control the realisation of the pledged asset. It has a money value, and can itself be ceded, and even pledged *in securitatem debiti.*"; further, Van Der Merwe et al in *Contract* 434-435 note the possibility of a "sub-pledge" to the extent that a pledgee can in fact *pledge* the extent of her interest in the original pledge object; and as per Van Der Merwe *Sakereg* at 463, according to Roman-Dutch authorities and case law (see n 258) a limited real right may be pledged to the extent of that right.

25 Lubbe (1989) *THRHR* 491.

26 See Chapter 4, § 4 3 2 2.

constitutes *effective control*. Further, control will always be determined with reference to the particular legal object in question."

Thus, in order to legitimately constitute a pledge *in securitatem debiti* in this context, it would appear that the pledgor must provide the pledgee with *effective control* over the pledge object, coupled with the requisite *animus* on the part of both parties.

Typical incident-functionalities that could serve as the legal object of pledge are the incidents of alienation, use (for example voting rights), or the drawing of *fructus*.[27] Isolated individual incident-functionalities may also be combined in a set to serve as the object of the real security. In this way, with the sole exception of the most basic and empty reversionary interest, larger sets of incidents gleaned from the security-asset may also form the economic substance behind the pledge. Such a more expansive pledge would seem to be closest to the traditional notion of the pledge of securities *in toto*, "which…entitles the cessionary to the exclusive right to enforce the ceded right, a right which he may exercise in the event of non-payment of the principal debt."[28]

From a policy perspective, a particularly useful outcome of this conclusion is that it enables legal (and commercial) certainty regarding the variability in terms of which a specific incident-functionality (or set of such functionalities) may be chosen to satisfy the parties' particular needs with respect to real security.

This solution does not *formally* resemble the traditional notion of a pledge *in securitatem debiti*, as the entitlement of execution (and all its potential incident-functionalities) already resides, *ab initio*, with the instrument-holder. That holder has no patrimonial interest to pledge. Logically, the asset-holder and a holder of lesser limited real *patrimonial* interest in the security are thus the only holders able to effect a pledge. Nonetheless, in *function*, this solution and the generic construction are the same. They both entail provision of *effective control* over an agreed-upon incident or set of incidents, except that the former effects this through the more indirect bestowal of control over the instrument-holder who, in turn, directly holds the entitlement of determination.

How, then, should the pledge of such an economic object be executed? It appears to be an established principle that a pledgee may, presumably depending on her economic needs, choose

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27 See Chapter 4, § 4 1 2:

> "there are many other incidents which have little to do with execution. Thus, lacking the incidents of execution, the remainder must include at least the various incidents of alienation (a personal right analogue to the *ius disponendi*). It also must include the incident of encumbrance, as a beneficial interest holder naturally remains entitled to cede a security in securitatem debiti. Further, it must also include the incidents of *usus* and *fructus*…"

28 Blackman et al *Commentary* § 133 5-367.

the manner in which (and to some extent the timing as to when) the value inherent in the real security is realised, so that:[29]

> "[t]he cessionary, as holder of the right to institute action…may proceed *directly by claiming performance* from the debtor and satisfying the principal obligation from the proceeds, *or* otherwise *indirectly* by taking [judgment] against the cedent and realising the ceded claim *by means of a sale in execution*."

There are a few important qualifiers in this regard. The direct method of realisation by direct enforcement may only be used where the right subject to the pledge is (1) enforceable, and (2) performance will yield value able to cover the entire principal obligation.[30] Further, in terms of the alternative method of obtaining judgment for sale in execution, *parate executie* clauses appear permissible but are still subject to the courts' oversight function in curbing its abuse by the pledgee.[31]

In terms of the timing of execution, while there is no actual *ex lege* duty to realise the real security when its underlying performance becomes due, "the cessionary-pledgee, as holder of the capacity to enforce the right, is entitled to, and even obliged to, claim the proceeds of the ceded claim from the debtor as soon as it becomes due, even though the principal obligation might not yet be due at that stage", unless otherwise arranged.[32]

Here a crucial distinction between the acts of enforcement of the pledged claim to performance on the one hand, and of "satisfaction of the principal [i.e. secured] obligation by the appropriation of the debtor's performance" must be strictly maintained.[33] Absent default, the "reversionary interest" (i.e. any and all incident-functionalities which remain under the effective control of the pledgor) will remain with the cedent, meaning that prior to execution the insolvency of the pledgee cannot affect the entitlement of the pledgor to claim those proceeds upon satisfaction of the secured debt. In default, however, there will be an appropriation by the cessionary-pledgee of the underlying value of the pledged incidents in execution.

On that basis, the only remaining issue at hand becomes a very practical one. If the pledge of securities is effected by a real agreement that requires providing effective control over the predetermined pledge object (i.e. *quasi-traditio*), coupled with the requisite real intent – how does

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29 Van der Merwe et al *Contract* 432-433 [own emphasis], citing *Stephens v Whitford* 1903 TH 231; *Cape of Good Hope Bank v Melle* (1893) 10 SC 280; *Volhand & Molenaar (Pty) Ltd v Ruskin* 1959 (2) SA 751 (W); *Swacina v Volkskas Bpk* 1964 (4) SA 716 (T); *Britz v Sniegocki* 1989 (4) SA 372 (D) 376; *Registrateur van Aandelebeurse v Aldum h/a Onecorp Group* 2002 (2) SA 767 (SCA).

30 Van der Merwe et al *Contract* 433 & n 386.

31 See *SA Bank of Athens Ltd v Van Zyl* 2005 (5) SA 93 (SCA); *Juglal v Shoprite Checkers (Pty) Ltd t/a OK Franchise Division* 2004 (5) SA 248 (SCA); *Bock v Duboro Investments (Pty) Ltd* 2004 (2) SA 242 (SCA); and *Contract Forwarding (Pty) Ltd v Chesterfin (Pty) Ltd* 2003 (2) SA 253 (SCA).

32 See Van der Merwe et al *Contract* 433, n 385, & n 388-389.

33 See Van der Merwe et al *Contract* 433 in n 389, discussing this distinction.

the pledgor provide the pledgee with "control over the instrument-holder" in respect of the incidents which serve as pledge object? Here one may examine two obvious techniques, and a more novel third.

The first is to put the pledgee on the securities register – i.e. simply transfer instrument-holdership to the pledgee. In such a case there is no need to bestow *control over* the instrument-holder because the pledgee *becomes* the instrument-holder. As such it directly bestows the global entitlement of determination of the security and for that reason looks near-exactly like the traditional pledge of personal rights *in securitatem debiti*, but (as set out above) effectively concretises the real right for slightly more subtle reasons.

From a policy perspective, this puts both parties in a very strong legal position vis-à-vis their respective interests. For instance, through the *ex lege* agency inherent in the relationship, the pledgor is well protected from any unlawful actions by the pledgee prior to the enforceability of the pledge. Conversely, the pledgee has the strongest possible basis with which to enforce her rights should the default event occur, as she becomes entitled to take what she is already entitled to enforce. The publicity element of the pledge is also well satisfied – registered holdership strongly evidences the existence of the pledge.

A second common method is to have the pledgor provide the pledgee with signed transfer forms (otherwise blank or already filled in to reflect the pledgee as transferee), most typically along with the security certificate. The certificate is no longer required by either the Companies Act or its regulations for a transfer, though it is most often a requirement built into the company memorandum.[34] This position must surely similarly apply in the case of pledge, though (as will be discussed below) it is particularly risky for all parties involved to conduct such a transaction without the accompanying certificate.

This method is the most analytically interesting and also most illustrative of the value of the relevant outcomes of this work. Such a pledge leaves either the pledgor (as security-holder) or the instrument-holder of the pledgor (as asset-holder) on the securities register. The role of the security certificate

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[34] In the context of company securities, a 14(b) of Table B, Schedule 1 of the Companies Act of 1973 entitled the directors of a private company to refuse a share transfer if the instrument of transfer was not accompanied by the share certificate. Neither the 2008 Act nor its Regulations contain a similar provision.

However, regarding transfer of the security *instrument*, Deport (*Henochsberg* § 51, 214) states – correctly – of the modern legal position that:

> "[a]s between the transferor and the transferee, it is the duty of the latter to obtain registration of the transfer. Section 51(6) does not require the certificate to be lodged together with the instrument of transfer but the Memorandum of Incorporation may preclude or restrict registration of transfer of a share unless the instrument of transfer lodged with the company is accompanied by the certificate of the share."

is typically crucial in this regard, but handing over of the certificate does not rise to the level of formality requirement for the valid constitution of the pledge.

How does the method establish control over the instrument-holder? The analysis must begin with what has occurred on the level of incidents. To this end, the pledge object must be established. From these facts the pledge object appears to be the full extent of the value of the pledgor's held interest in the security. This is because the pledgor has provided the pledgee, through provision of signed transfer forms, with mastery (*heerskappy*) over the ability (or rather incident-functionality) to dispose of the security to her advantage – i.e. the *ius dispondendi.* Thus, default can have as consequence that the pledgee either takes transfer of the security asset in own name to reap its benefits, or sells the security to a third party in execution upon default.[35]

In this scenario it does not matter who the instrument-holder is, as all the pledgee must do to exercise her right in execution is complete the transfer form and provide the issuer with that transfer form. Theoretically, this would trigger the necessary actions on the part of the issuer in completing the disposition.

In order to amount to a juristic act that successfully creates a limited real right of pledge, the handing over of blank (or partially filled in) and signed transfer forms must isolate the legal object (i.e. the as-yet-unrealised value of the security asset as a whole) from future acts of infringement by the pledgor. It must do so by providing the pledgee control over the instrument-holder to an extent determined by the nature of the object which was pledged. The requirement of effective control is satisfied because control over the *ius disponendi* enables the pledgee, lawfully, *to direct the instrument-holder in all matters regarding the realisation (through transfer, in execution, of holdership) of the economic value serving as real security*. As the certificate is no longer required to complete the transfer, triggered by the default on the principal debt, the handing over of the forms will – as point of departure and barring any provision in the memorandum stating otherwise – satisfy this requirement.

Nonetheless, it is anticipated that there may be an intuitive discomfort with this explanation. This discomfort stems from the fact that this juristic act does not necessarily create the impression of having *sufficiently* isolated the security from later acts of disposal by the pledgor. What would prevent the pledgor from fraudulently completing a second transfer form and (in order to transfer the security to a third party in violation of the pledge agreement) provide this form to the third party transferee to hand over to the issuer, who – none the wiser – will action the transfer? In the current scenario,

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35 The distinction between the pledge object itself (in this case the value of the security asset, or of the pledgor's held interest therein) and the means of handing effective control thereof over to the pledgee (in this case the provision of the incident of *ius disponendi*) is crucial, as the two can easily be conflated in this context. A good example of the importance of this difference between can be found in *Van Der Berg v Transkei Development Corporation* 1991 (4) SA 78 (Tk).

where no security certificate has been handed to the pledgee alongside the transfer forms very little, factually, prevents such an act. The risk is further increased as this second transfer form may be provided together with the security certificate, lending further credibility to the appearance of lawfulness of this second and unlawful dispositive act.

However, unlike in the case of the transfer of uncertificated securities (or limited interests therein), the decisive test cannot be whether the pledgee's intended relationship to the pledge object is *immutably* protected in fact. Instead, the question of sufficient isolation or protection is addressed by two mitigating factors. First, at the time of creation of the pledge, the handing over of blank, signed transfer forms puts the pledgee in a sufficiently strong factual position of effective control vis-à-vis the *ius disponendi*. It seems readily apparent that hypothetical factual occurrences cannot, on their own, be decisive in the prior creation of the real agreement of pledge. This is especially true when the hypothetical counterfactual position is premised on an intervening fraudulent act.

The requirement is also forward-looking, requiring that the act must isolate the pledge object from future acts of disposal by the pledgor. This is not a problem, as *after the creation of the pledge* the pledgee's relationship with that object is indeed still sufficiently protectable. If faced with a later, unlawful, disposing act by the pledgor, the pledgee must merely be able to approach the appropriate adjudicatory forum (typically a court) and prove the prior existence of the real right of pledge. To do so, the pledgee must show that on a balance of probabilities the pledgor did not have effective control of the *ius disponendi* and thus was not lawfully enabled to dispose of the security or any relevant incident thereof. The transfer forms alone should provide the pledgee with the evidentiary basis to do so.

In sum, the manner in which control over the pledge object is bestowed by this method is sufficiently factually effective at its inception and sufficiently protectable thereafter. Nonetheless, it remains extremely risky to be party to such a pledge without the involvement of the certicate or certificates.

Effective control of securities, as per § 4 3 2 2 of Chapter 4, requires effective factual control coupled with a particular controlling intent. The above is not to say that this is not the case with pledge. Rather, it is to say that where a pledgee is lawfully enabled to direct the instrument-holder with respect to the pledge-affected incident or incidents, that legal enablement provides a *sufficiently factual* basis for the required degree of on-going control. By way of analogy, consider the possibility that the pledgor of a car may subsequently and unlawfully reacquire possession of the car and purport to sell that car to a third party. This hypothetical eventuality cannot, by itself, cause the law not to recognise, at inception, the pledge simply because the pledge object is not fully isolated from further dispositive acts by the pledgor. However, an important caveat is the principle that if a pledgee voluntarily parts with control over the pledge object, she loses her real right.[36]

Finally, although such a pledge will be effectively constituted, the position of the pledgee without the certificate is weakened by her evidentiary arsenal. If the blank transfer forms are not dated, the pledgee-plaintiff may be without the ability prove *prior in tempore* – this position may be so weak, in fact, that it might negate the constitution of a real right. This will make defending the right against subsequent unlawful disposition very difficult. Moreover, there is the possibility of losing the ability to enforce the pledge due to a successful invocation of the defence of estoppel, flowing in main from a reasonable reliance of the second, *bona fide* unlawful acquirer.[37] The reliance will be further strengthened if the third party has received the security certificate. The element of publicity is of absolute importance. The handing over of the blank transfer forms sufficiently isolates the pledge object. However, the element of publicity is weak on such facts – that is the root cause of the weakened position of the pledgee. In § 4 3 2 3 of Chapter 4 it is stated that:

> "*the true role of the security certificate is to indicate who has effective factual control of the security, or one of its subsidiary elements*.
>
> Such an understanding of the role of the security certificate completes the view of the factual features of security-holdership. The evidentiary, publicity, and reliance-strengthening functions of the certificate are all elements of this deeper role as factual and physical indicator of control, allowing the law to better make factual determinations in a proprietary sense, without losing the essentially obligationary character of the securities construct in South African jurisprudence."

Thus, in terms of this method of pledging a security, handing over of the security certificate plays a critical role. Although not a formality requirement for the constitution of the pledge,[38] handing over possession (in the true, corporeal, sense) of the certificate fulfils a powerful publicity function in strengthening the pledgee's legal position, enhancing the certainty and defensibility of her rights. It

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36 See Van der Merwe et al *Contract* 435 & n 401-402.

37 It would, strictly, be irrelevant whether this acquirer purportedly acquired the security, the security asset, or some limited interest in the security.

For a full discussion of estoppel and reliance in this context, as well as the relevant authorities and principles, see Chapter 10.

38 The *locus classicus* for this position is *Botha v Fick* 1995 (2) SA 750. See also *Lief v Dettman* 1964 (4) SA 252 (A) 271.

is therefore no surprise that this method of pledge, in practice, is most often supplemented by the handing over of security certificate alongside the blank and signed transfer forms by the pledgor.[39]

This analysis shows that a pledge of a debt security *in securitatem debiti* using either of these two already prevalent methods is not only entirely in harmony with the outcomes of Chapter 4, but also very well accounted for using its deeper theoretical framework.

However, based on the outcomes of this work, it is conceivable that there is also a third, as-yet probably unused and fairly simple method to effect the pledge of a security. It rests on the better understanding of the agency operative between instrument- and asset-holder. This method is to perform a juristic act to alter the relationship existing between the instrument-holder and asset-holder, and thereby include a third party – the pledgee as interest-holder. There is no obvious reason why the content of agency cannot be altered by verbal or written agreement, or be supplemented by a mandate, and this is often seen in intermediated chains of holdership in the uncertificated context.

The precise manner in which it is done need not be dealt with, as there is innate variability to effecting the necessary change. However, two suggestions seem most practicable. The first is to emulate the manner in which pledge is achieved in the uncertificated environment (as discussed in the following section). This would entail an alteration of the security instrument manifesting in the entry of the pledgee *in addition to the instrument-holder* in the securities register. This possibility appears to be recognised by the Companies Act if s 1 *viz.* "beneficial interest" is read with s 51(5) [own emphasis]:

> "[s 1]: **"beneficial interest"**, when used in relation to a company's securities means the right…to:
>
> (a) receive or participate in any distribution in respect of the company's securities;
> (b) exercise, or cause to be exercised, in the ordinary course, all or any of the rights attaching to the company's securities; or
> (c) dispose or direct the disposition of the company's securities, or any part of a distribution in respect of these securities…
>
> [s 51:]…(5) Subject to subsection (6), a company must enter in its securities register every transfer of any certificated securities, including in the entry…
>
> (b) the description of the securities, *or interest transferred*…"

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[39] See Blackman et al *Commentary*, § 133, 5-370 – 5-370-1:

> "delivery of the certificate may, in the circumstances, be a vital factor as a matter of evidence of the cession."

Though it has no equivalent in the Companies Act of 2008, s 136 of the Companies Act of 1973 ("Certification by company that security has been lodged for transfer") is instructive in terms of the relationship between the certificate and issuer, on the one hand, and transferring parties on the other.

One should, however, be careful not to read too much into this expansive definition, specifically as it is aimed more at regulatory purposes. Moreover, the deeper interpretive complexities of the Companies Act are beyond the scope of this work. Suffice it to say that it appears as though a *limited* beneficial interest as described in (a) – (c) in the provision should probably correspond to the "interest" described in s 51(5)(b). As the security instrument manifests in the form of entry on a securities register, the effect would be to *modify the security instrument itself* to include the pledge-holder as holder of an interest in a security.

This would, by operation of law, create a tripartite relationship within the scheme of agency, and the register's demarcation of the pledge-holder's interest in the security would delineate the extent of the instrument-holder's duties and fiduciary responsibility towards that holder vis-à-vis the asset-holder. This method may even, depending on how it is recorded, bestow upon the pledgee the ability to deal with the issuer directly, providing specific incident-functionalities associated with the security *instrument* rather than only the security asset (i.e. incidents of execution as consequences of the entitlement of determination).

A second variant is simply to formalise and modify the relationship between asset- and instrument-holder to substitute the effective control of the asset-holder with that of the pledgee *in respect of the pledge object*. This would, similarly, make the instrument-holder beholden to the directives of the pledgee in a manner that sufficiently isolates the incident-functionalities agreed upon by the parties to serve as the object of real security. In so doing, the instrument-holder's fiduciary agency should become beholden to all lawful directives of the pledge-holder regarding the incident-functionalities which are the subject of the pledge, and not the asset-holder. Such an arrangement fully accords with the underlying principles discussed in the beginning of this section: a degree of control over the (defined) pledge object is provided to the pledgee through control over the instrument-holder. The control is without doubt enough to sufficiently isolate the pledge object from future disposing acts by the pledgee, satisfying the requirements for the constitution of the real right.

The ultimate conclusion of this section is that the principles applied to the pledge of corporeals are, with the necessary adaptation, far more doctrinally appealing *and* more pragmatic in the pledge of securities *in securitatem debiti*. Further, those methodologies that have been established in commercial practice are also not at all contrary to the outcomes of this work, but rather slightly improved by the more refined understanding of securities as provided in Chapters 4 and 5.

9 1 2 Uncertificated securities as real security

The discussion and outcomes of the previous section allow for a simpler and more concise discussion of the provision of uncertificated securities as real security. The focus of this section is to apply the principled approach of the previous section in coming to a correct understanding of the statutory framework in place for the cession of securities *in securitatem debiti*. This section, unlike the previous section, must accordingly deal with all forms of such security cessions. The discussion centres around s 39 of the Financial Markets Act 19 of 2012.

9 1 2 1 The scope of s 39(1)(a)

The first provision which must be dealt with is s 39(1)(a). It reads as follows:

> "Pledge or cession of uncertificated securities in securitatem debiti – (1) (a) A pledge or cession *in securitatem debiti*, as constituted by an agreement, in respect of uncertificated securities or an interest in uncertificated securities held by a central securities depository, participant, authorised user or nominee, as the case may be, must be effected by entry in the central securities account or the securities account, as the case may be, of—
>
> (i) the pledgor in favour of the pledgee specifying the name of the pledgee, the number or nominal value of the uncertificated securities, the interest in the uncertificated securities pledged and the date of entry; or
>
> (ii) the cedent in favour of the cessionary specifying the name of the cessionary, the number or nominal value of the uncertificated securities, the interest in the uncertificated securities ceded and the date of entry, as the case may be."

This section provides that both any pledge of securities and any cession of securities can only – the use of "must" being strongly peremptory[40] – occur through *entry*[41] of the security-taker in the applicable securities account of the pledgor or cedent providing the real security. The minimum information which must be reflected by the entry is clear from the above.[42]

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40 Note in this regard the following view, which is supported here, in JL Yeats, R de la Harpe, R Jooste, H Stoop, R Cassim, J Seligmann, L Kent, R Bradstreet, RC Williams, MF Cassim, E Swanepoel, FHI Cassim & K Jarvis, *Commentary on the Companies Act of 2008* 2-1082:

> "While s 39(1) of the FMA uses the imperative when prescribing the manner in which a security cession 'must be effected' by the relevant entries, it remains to be considered by our courts whether a failure to comply with such requirements would render the security cession void or voidable or possibly only unenforceable against third parties. While the FMA does not clarify what the consequences of non-compliance are, there is clearly a forceful argument that the security cession will not have become effective due to non-compliance based on the peremptory wording."

41 See the discussion on "entry" in § 5 1 1 of Chapter 5, and its ramifications as discussed in § 5 1 2 and § 5 1 3.

42 In this regard the FMA provides more detail and clarity than its predecessor. Under s 43 the Securities Services Act, the "number of nominal value" of the securities subject to the cession was not a requirement, although in Blackman et al *Commentary* § 91A, 5-236-2 the suggestion is made that:

> "the STRATE rules and practice note [i.e. the Practice Note in respect of Rule 6.7.4 of the STRATE Rules effective from 1 July 2006 – see n 1 therein] dealing with the information that must be disclosed to the pledgor do imply that a record in the securities account effecting the pledge or cession should mention the specific securities that will be subject to the pledge or cession."

See also Yeats et al *Commentary 2008* at 2-1075 n 292 regarding the contents of the entry as per Strate Rules in the equities context.

In light of § 5 1 of Chapter 5, the use of "held" in s 39(1)(a) should be distinguished from the use of "held" in s 38.

On the one hand, s 38 deals with:

> "transfer of uncertificated securities or an interest in uncertificated securities on the uncertificated securities register held by a central securities depository or participant…by making debit and credit entries respectively in the central securities account or securities account…kept by the central securities depository or the participant…"

Here the object of reference of "held" is clearly the *uncertificated register* itself, as "kept" by the CSD and CSDPs through their respective accounts. This is a clear reference to the custodial function, specifically that function at register-level. This also accords with the conclusion in § 5 1 3 of Chapter 5 that "ownership" and status as being held collectively or not must be determined at register-level, though this may be influenced by what is contained in securities accounts at lower levels.

On the other hand, s 39(1)(a) deals with:

> "pledge or cession *in securitatem debiti*…in respect of uncertificated securities or an interest in uncertificated securities held by a central securities depository, participant, authorised user or nominee…effected by entry…"

In this case, the object of reference of "held" appears to be the securities themselves. Does this mean securities held in terms of the custodial function or administrative function? It is submitted that it cannot refer to the administrative function – an instrument-holder could indeed be a CSD, CSDP or authorised user in own name, or any (approved) nominee, but if that was the intention the list is incomplete because it does not refer to own name *security*-holders (i.e. those who are direct clients of a CSD or CSDP).

The better reading is that it refers to the custodial function and therefore the manner in which real security is created and evidenced by entry within the system of accounts. It is useful for this discussion to understand the kind of entry required as follows:[43]

> "The entry (commonly referred to as 'flagging') must be recorded in the cedent's (pledgor's) securities account in favour of the pledgee specifying: (i) the name of the cessionary; (ii) the number or nominal value of the uncertificated securities; (iii) the interest in the uncertificated securities ceded; and (iv) the date of entry."

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43 Yeats et al *Commentary 2008* at 2-1076.

This raises a key question as to the intended import of the inclusion of *non-register level* custodial functionaries in s 39, especially in contradistinction to the clear limitation to register-level accounts in s 38.

The first possibility is that it contemplates the creation of real security through entry in either register *or* non-register level securities accounts. Though plausible, this is not the preferred reading of this work. In § 5 1 3 of Chapter 5, it was argued that both asset-holdership and co-asset-holdership are determined at register-level (the latter occurring where security assets have commingled within the system of accounts and are thus held collectively). Chapter 8, in § 8 2, also makes it clear that transfer of asset-holdership occurs by means of quasi-delivery at register level. The commonality of these outcomes, for present purposes, is that real rights, and indeed real effect, are determined by what occurs on the uncertificated securities register.

There is little reason why this should not also apply in the context of pledge or cession *in securitatem debiti*. Therefore, for real effect, it is submitted (based on the principles of effective control as articulated in § 9 1 1 above, coupled with the notion of register-level and non-register securities accounts articulated in § 5 1 2 of Chapter 5) that the entry must modify the *uncertificated securities register* itself.

This brings one to the second possibility, which is supported as correct here. This approach posits that the reference to all keepers of securities accounts points to a distinction built into s 39(1), between securities that are held collectively and those that are not. This is most likely, again, "out of an abundance of caution, rather than as a result of technical exactitude".[44] The approach breaks the first portion of the provision into two parts:

> "A pledge or cession *in securitatem debiti*…in respect of [1] of uncertificated securities or [2] an interest in uncertificated securities held by a central securities depository, participant, authorised user, or nominee, as the case may be…"

The first part refers to scenarios where securities are not held collectively, and is therefore custodian-neutral. The second part refers to scenarios where they are held collectively, and therefore must specify that the commingling may occur because of the manner of *custodial holding* at CSD, CSDP, authorised user or nominee level. This becomes apparent through the analysis of § 5 1 3 of Chapter 5, which establishes (contingent on the nature of the system and praxis of the various system actors) that: security assets commingle when, upon examination of instrument-holdership across *all tiers* of

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44 Yeats et al *Commentary 2008* 2-614.

securities accounts, specific instrument-holdership at *register-level* of a *bloc* of securities cannot be allocated to the specific holdership of an individual holder of a specific number of security assets.[45]

On that reading one may then interpret the rest of s 39(1), i.e. "must be effected by entry in the central securities account or securities account, as the case may be…", *narrowly* as referring only to the register-level accounts of CSDs and CSDPs. In the same manner as has been done for s 37,[46] this allows one to reconcile (1) the FMA's reference to custodians of all tiers, with (2) the fact that proprietary matters such as "ownership" and (in this case) real security must be determined at register-level, to prevent the fragmentation or "duplication of ownership [and for present purposes other limited real] interests"[47] across the various tiers of holdership.

This then brings the discussion to the difficult relationship between s 39(1)(a)(i) and (ii), and s 39(2). The latter subsection reads as follows:

> "This section does not apply to an out-and-out cession in respect of securities or an interest in securities and such a cession must be effected in accordance with section 38."

This section had no equivalent in the Securities Services Act: it appears to be a new feature of the legislative scheme.

As per § 8 2 of Chapter 8 it should be clear that, as point of departure, s 38 governs transfers (i.e. cessions) of: (1) security-holdership; (2) instrument-holdership; and (3) asset-holdership. Therefore, the exclusion in s 39, as read with ss (1)(a)(i) and (ii) can be approached in one of three ways.

The total exclusionary approach

This approach holds that s 39 deals only with pledge, to the total exclusion of all fiduciary cessions *in securitatem debiti.* It starts with the following assumption:[48]

> "Section 39(1) of the FMA regulates cessions in security following the pledge construction, while s 39(2) of the FMA makes it clear that a transfer for security by way of an out-and-out cession (*fiduciary cession*) is permissible following the usual requirements for a transfer of uncertificated securities as regulated by s 38

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45 See specifically *Figure 7* in § 5 1 3 of the Chapter 5.

46 See § 5 1 3 of the Chapter 5.

47 Meissner (2019) § 13 2 3 4, 244.

48 This is the view of Yeats et al *Commentary 2008* as per 2-1076 [own emphasis].

Also note, also for what follows, in terms of pledge as the default construction, the comments of Yeats et al *Commentary 2008* at 2-1075 n 291 – "Interestingly, s 39(1) of the FMA has reverted to the use of the Latin term '*in securitatem debiti'* previously used in s 6 of the Custody and Administration of Securities Act of 1992, which had been repealed earlier by the subsequently repealed Securities Services Act, 2004, which simply referred to a 'cession to secure a debt'."

of the FMA, read together with s 53(1) and (2) of the Act, and must be complied with to effect such a transfer for security."

This means that the sections regulate only a *pledge*, in the true sense, of: (1) the security or of the security asset (the nature of which is adequately dealt with in § 5 1 of Chapter 5).[49] As supplementary interpretive support for this approach, *Grobler v Oosthuizen* made it clear that pledge was to be considered the default construction of a cession *in securitatem debiti*. There the dictum[50] makes a number of issues clear: (1) due to policy considerations of legal and commercial certainty, (2) the pledge construction is to be considered the default construction of a cession *in securitatem debiti*, but (3) the parties may still expressly intend to make use of the fiduciary cession construction and this will be given effect to.[51]

However, a fiduciary cession *in securitatem debiti* is an outright cession of an obligation or complex of obligations (e.g. a security), on which is superimposed a *pactum fiduciae* to ensure cession back to the pledgor if settlement of the secured debt has occurred.[52] In such cases no reversionary interest, nor any element of a ceded right or set of rights, remains with the pledgor during the lifetime of the principal debt.

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49 Note in light of § 5 1 of Chapter 5, and for purposes of this entire section, the following from Yeats et al *Commentary 2008* 2-1076 – 2-1077 and 2-1079:

> "It is clear that the security over the uncertificated securities is still effected by way of a cession of the rights constituting the securities or interests therein, with added formalities…Section 39(1) of the FMA contemplates a cession in security of either the uncertificated securities or an interest in uncertificated securities. This gives rise to the ambiguity in relation to the transfer of ownership interests…On the one hand, the FMA contemplates the possibility of a co-ownership interest in respect of collectively held securities and, on the other hand, an interest in a specific number of uncertificated securities…
>
> From s 37(1) of the FMA, it appears that where securities are collectively held, the investor does not directly own any particular uncertificated securities. Accordingly, it would ordinarily follow that the investor could not effect a cession of the rights comprising any particular uncertificated securities as part of the security provided. Perhaps this is why s 39(1) of the FMA contemplates the possibility of a cession in security of uncertificated securities or an interest in uncertificated securities. Where the investor has only a co-ownership interest, it would follow that the cedent cannot cede more rights than he has and from this, it follows that the co-ownership interest would be ceded in security.
>
> [A]ccordingly, where the securities are held collectively in a securities account, the cessionary would only acquire security over the cedent's co-ownership interest and therefore runs the risk of having to share in any shortfall in the relevant securities account."

50 2009 (5) SA 500 (SCA) [11], [17]-[18] and [24].

51 See also, for instance, comments in Lubbe "Cession" in LAWSA § 180 – "An important ancillary issue is whether the pledge construction has subsumed the entire field of security cessions, thereby in effect proscribing an alternative form of security, that is to say, a full cession coupled with a *pactum fiduciae*. The better view is that it has not done so. In the result parties should be permitted to structure their security either way. Whether it is to be the one or the other will ultimately depend on their intention. Where that intention is not clearly expressed, the pledge construction will prevail."

52 See for instance: *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA) [17] ("the ceded right in all its aspects is vested in the cessionary"); Lubbe "Cession" in LAWSA § 180 ("…an outright cession on which an undertaking (*pactum fiduciae*) is superimposed that the cessionary will restore the principal debt to the cedent on satisfaction of the secured debt."); Van der Merwe et al *Contract* § 12.5.3, 425-426 ("…a complete transfer of the right to the cessionary for the purposes of security only…"); D Hutchison & C-J Pretorius (eds) *The Law of Contract in South Africa* (2010) §14.6.1 367-368 ("…unlike pledge, the full title of the right passes to the cessionary; there is complete transfer of the right, albeit for security purposes only…); or Blackman et al *Commentary* § 133, 5-367 ("Instead of pledging his rights, the shareholder can simply cede them to the other party subject to an agreement…that, on discharge of the debt, the other party (the cessionary) will cede them back…").

If s 39 excludes all of these "out-and-out" cessions *in securitatem debiti*, it raises a serious question as to what type of cession s 39(1)(a)(ii) is referring to *in contrast to* a pledge *in securitatem debiti* as per ss (i). This approach to s 39 cannot solve this problem and requires a reading down of ss (1)(a)(ii) as redundant, so that s 39 only caters for the pledge construction, despite its express mention of cession in contradistinction to pledge.

The qualified exclusionary approach

This approach broadly follows the same logic as the total exclusionary approach, but attempts to remedy the issue of s 39(1)(a)(ii) as outlined above. It posits a third possible means of real security: the limited *out-and-out* fiduciary cession of smaller subsidiary elements of the entitlement of enjoyment by the asset-holder (e.g. a limited cession creating a limited real right *usufruct*) as security for a principal performance. It then posits that these special cessions are what is intended to be regulated by ss (ii), whilst out-and-out fiduciary cession *in securitatem debiti* of security- or asset-holdership is what is referred to in ss (2) and must be regulated by s 38.

When analysed at the level of incidents, it is clear that lesser, *individuated incident functionalities of the security asset* may[53] be made subject to a limited real right vesting in a third party, such as a *usufruct* or *quasi-usufruct* in securities.[54]

Asset-holdership of securities has more than one facet of economic value which may serve as real security. The chosen incident-as-object of real security may be the right to dispose of the security; it may lie in the right to enjoy performance by the debtor; or it may even lie in the right to enjoy the fruits of the security (e.g. dividends or interest in the form of so-called coupon payments) for the amount of time it takes to satisfy the amount outstanding on the defaulted-upon principal debt.

Thus, at least theoretically, it should be possible for the cessionary and the cedent to expressly intend that an economically valuable incident functionality should be provided to the security-taker outright, but still subject to a *pactum fiduciae* for re-cession of that incident functionality provided the principal debt is repaid. The best example of this approach would be a fiduciary usufruct *in securitatem debiti* – i.e. the bestowal, by way of limited cession, of a *usufruct* coupled with an agreement to reverse the limited cession (and extinguish the limited real right) once the principal debt is duly repaid.

The underlying legal mechanics of this are also reasonably clear: through a bilateral exercise of legal subjectivity an incident functionality, or set of incident functionalities, which has economic value is

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53 Barring some superordinate defect (e.g. unlawfulness) or policy obstacle (e.g. a *contra bonos mores* juristic act).

54 See § 9 2 below, as well as specifically E Leos "Quasi-usufruct and shares: some possible approaches" (2006) 123 *South African Law Journal* 126 (and authorities discussed therein).

made subject to a limited real right that is not a pledge. In § 8 2 1 of Chapter 8 it was argued that the cession (i.e. transfer) of uncertificated securities was an exception to the rule that cession need not be factually effective to be valid – *quasi-traditio* in the form of a debit and credit in the applicable securities accounts was a further statutory formality requirement. The same principle holds here: *quasi-traditio* in the form of electronic entry at register level (also known as flagging) is required by s 39(1)(a)(ii). Thus, entry coupled with the requisite real intent simultaneously perfects the limited cession and the limited real right.

Admittedly this is a particularly esoteric construction,[55] but it enables one to take a broadly exclusionary approach and still make sense of the full import of s 39(1)(a), as well as ensuring full coverage of all kinds of security cessions in terms of the Act.

On that basis s 39(1)(a)(ii) deals with cession of a limited real interest in securities *in securitatem debiti*, and s 38 deals with transfers of securities and perhaps also transfers of other limited real interests in securities not for purposes of securing debts.

If this view is taken, there are three possible species of cession *in securitatem debiti* of uncertificated securities. The first is an out-and-out fiduciary cession effected in terms of s 38 (and the relevant provisions of the Companies Act) rather than s 39, the real effect of which is to bestow security- or asset-holdership upon the cessionary outright, subject to a *pactum fiduciae*. The third is a *limited* fiduciary cession effected in accordance with s 39(1)(a)(ii), the real effect of which is to bestow holdership of a limited real interest in a security upon the cedent outright, subject to a *pactum fiduciae* and flagging in the uncertificated securities register through entry in the relevant register-level central and securities accounts. This more limited fiduciary cession is also subject to the more stringent requirements and rules of s 39 as compared to s 38. The third is the pledge of the security, security asset or a specific incident functionality or set of functionalities ("or an interest in securities") as *pledge*-object in accordance with s 39(1)(a)(i), establishing a real right of pledge.

This is seemingly also supported by s 39(1)(c):

> "The pledgee or cessionary of uncertificated securities or an interest in uncertificated securities referred to in paragraph (a) is entitled to all the rights of a pledgee of movable property or cessionary of a right in movable property pledged or ceded to secure a debt."

There would appear to be little else to which "the rights of a…cessionary of *a right in* movable property…ceded to secure a debt" could be referring to, other than the cession of a limited real right

[55] Comments in *Grobler v Oosthuizen* (5) SA 500 (SCA) in [24] regarding the "esoteric" legal dynamics of the pledge seem more aimed at protecting legal laymen, and (whilst still valid) may be taken with a grain of salt in the context of the often large, sophisticated, and legally shrewd financial actors found in the context of securities and the financial marketplace.

such as the right of *usufruct* (irrespective, theoretically, of whether in respect of an interest-bearing bearer instrument in terms of the common law, or a security in terms of the Act).

In very concise terms, s 39(1)(a) and (c) can be thought of as providing for *quasi-delivery* and publicity in the pledge or *limited* cession of uncertificated securities *in securitatem debiti*.

Furthermore, s 39(1)(a)(ii), as a *specialis* provision, implicitly appears to recognise more limited cessions because of its requirement that the flagging entry must denote “the interest in the uncertificated securities” that has been ceded *in securitatem debiti*. The requirement to specify *what* interest has been ceded could be read as envisaging different kinds of interests, rather than merely ensuring coverage of securities that are collectively held. Therefore, that recognition can be argued to override the reference to “interests in securities” in s 38, which in context becomes a *generalis* provision. Thus, the reference in s 39(2) to s 38 could be read to exclude out-and-out transfers that are limited fiduciary cessions *in securitatem debiti* creating limited real rights. Importantly, the converse is that *fiducia* cessions *in securitatem debiti* of the full underlying interest (i.e. full security-, or asset-holdership) remain covered by s 38.

While plausible, this approach is not uncontentious, could be seen as somewhat strained in its reading of the provisions, and ultimately the inclusive approach, below, is both simpler and more compelling.

The inclusive approach

The third approach posits that s 39(2) could simply be a clarifying provision which confirms that *any* cession that is not *in securitatem debiti* (i.e. any cession which is not a pledge *or* a fiduciary security cession) must be effected in terms of s 38. This approach also reads s 39 as a *specialis* provision that overrides s 38 as a *generalis* provision, but in a broader way than the manner in which this reasoning is deployed as per the qualified exclusionary approach above.

Thus, despite being on first principles substantively identical to an ordinary transfer, an out-and-out security cession (i.e. transfer of security- or asset-holdership) would be subject to a different regime of transfer than that of s 38. This would, presumably, be primarily due to a publicity-based policy imperative to require *flagging* within the uncertificated securities register.

While this is favoured approach, legislative intervention to clarify this provision is strongly advocated for here.

9 1 2 2 Other relevant elements of s 39

Due to the deep interpretive difficulties of the previous section, what follows will deal only with pledge, regardless of the correct approach to s 39(1)(a).

The next relevant portion of s 39 is s 39(1)(b) read with (d). Again, in very concise terms, these sections appear to deal with *effective control* and *real effect*. The sections read:

> "(b) Uncertificated securities or an interest in uncertificated securities referred to in paragraph *(a)* may not be transferred or otherwise dealt with, and no instruction by the pledgor or cedent may be given effect to, without the written consent of the pledgee or cessionary.
>
> …
>
> (d) A pledge or cession *in securitatem debiti* effected in accordance with paragraph *(a)* is effective against third parties."

Section 39(1)(b), speaking to *effective control*, will be dealt with first. The pledge of a certificated security must, along with the requisite real intent, bestow effective control over the instrument-holder. It must further do so with respect to the incident-functionality or set of functionalities that satisfies the pledgee's need for real security. As this entry must also specify the extent of the interest, *quasi-traditio* by ledger entry demarcates exactly what is fictionally being handed over in the out-and-out cession or pledge of the limited real interest serving as security object.

The effect of (b), however, is to regulate the exact nature of the effective control that such quasi-delivery bestows. The provision is necessary because the quasi-delivery in question is: entry of the particulars of the security-*taker* onto the client securities account that reflects the instrument-holder of the (asset-holding) security-provider.

This entry in the securities register adds the identity and particulars of the pledgee as real right-holder to the register. Yet it should be seen to reinforce, rather than detract, from the dynamics of agency of the security instrument in affirming that the relationship is now tripartite, including the pledgee to the extent of her registered interest. This interpretation reads "without the written consent of the pledgee or cessionary" as modifying the manner in which instrument-holders may receive and execute instructions from holders of patrimonial interests in securities. Read thus, s 39(1)(b) operates to confirm and regulate, explicitly, a change in the scheme of agency that existed prior to quasi-delivery of the object of real security.

The permissive authority it bestows on the pledgee operates to force the instrument-holder to exercise the incidents of execution in accordance with the directives of both asset-holder and (where relevant and appropriate) the pledgee, extending also the fiduciary dimension of that *sui generis* agency to the latter. This further allows for a more defined view of the limitations of the asset-holder's position once the entry has been made. It is extremely doubtful whether the Act is intended to limit the asset-holder's ability to enjoy aspects of the security unaffected, or not impugned, by the interests of the real security holder. Thus one may, and probably should, infer that the ability of the security-taker to *refuse* consent should be limited to those instructions issued by the former which adversely affect her security interests.

Requiring the consent of a holder of real security before *any acts of disposal can be concluded by any other holder* is the very essence of effective factual control where required for the purposes of pledge. For a pledge in terms of s 39(1)(a)(i), it satisfies the full set of first principles set out in the previous section as they relate to the pledge of certificated securities. It provides a degree of *heerskappy* over the pledge object that sufficiently isolates it from interference by the security-provider, thereby providing the foundation for the legitimate creation of a real right.[56]

This is then accentuated by s 39(1)(d), which serves to reconfirm (albeit superfluously) the real nature of the rights of the pledgee.

The cumulative effect of s 39(1)(a)-(d) can be summarised as follows. In terms of ss (a), entry of F's particulars *publicises* a second, limited patrimonial interest in the security. In terms of *(b)*, a negatively-formulated duty to adhere to the directives of F (in so far as she is entitled to direct C) is further created in support of the second securities account entry. As succinctly stated by Blackman et al, "the main reason for the 'security entries' is to give notice to the participant and third parties and to restrict transfers by the cedent".[57]

In terms of transmission, rather than transfer:

> "(e) Nothing in this section prejudices any power of a participant or central securities depository, as the case may be, to effect a pledge or cession in securitatem debiti to a person to whom the right to any uncertificated securities or an interest in uncertificated securities referred to in paragraph (a) has been transmitted by operation of law."

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[56] If one countenances the inclusive or qualified exclusionary approaches, a limited cession (e.g. a *quasi-usufruct cum fiduciae*) in terms of (ii) is of less foundational effect, but still important. In that context, it appears explicitly to entrench the position of a cedent in a manner which similarly protects and isolates the held real security-interest – not so that it might be duly recognised and constituted in law, but so that it may be sufficiently strong enough to be viable. One might argue that it is indispensable due to how tenuous the (very abstract) position of the limited cessionary *in securitatem debiti* of a patrimonial interest in an uncertificated security appears to be.

In terms of this second interpretation, the security instrument remains undivided, and the instrument-holder still retains all incidents of execution of rights and other competencies.

[57] Backman et al *Commentary* § 91A, 5-237.

Transmission has been sufficiently discussed in Chapter 8, and those principles will – with the necessary modification – suffice also here.

This leaves only s 39(3):

> "An interest in respect of uncertificated securities may be granted under this section, where applicable, and in the manner provided for in the depository rules, and is effective against third parties, in relation to a central securities account or a securities account, where such an interest extends to all uncertificated securities standing to the credit of the relevant central securities account or securities account at the time the pledge is effected."

This makes provision for a pledge granted over the *totality or a portion of the totality* of a security-provider's securities. Naturally a single securities account entry – which as a point of departure establishes instrument-holdership – may reflect a specified number of securities. Thus the applicable account often reflects an aggregated (i.e. global) instrument-holdership. The principles outlined above would then be equally applicable on that aggregated basis and no further discussion is required here.[58]

A final issue concerns the effect of s 41(1) of the Act, which provides that:

> "An entry effected in terms of section 38 or 39 is valid and effective against third parties despite any fraud or illegality that may have resulted in the entry being effected, unless a transferee to the transaction resulting in the entry was a party to or had knowledge of the fraud or illegality."

When comparing this provision to its equivalent in the Companies Act – i.e. s 53(4) – the wording of the latter ("transfer of ownership") suggests that it does not apply to transfers made in terms of s 39, so that these transfers may be regarded as governed solely by s 41(1) of the FMA. Unlike the Companies Act, this provision does not extend to entries made despite the insolvency of the security-provider. This could potentially have important ramifications in the context of real security – if a pledge, limited cession, or *fiducia* cession *in securitatem debiti* is deemed a disposition that can be set aside, should the entry be reversible in the absence of fraud and knowledge? Such an order is retroactive, rendering the disposition at least voidable.[59] However, that is not the same as illegality and if the letter of the Act is to be considered decisive the disposition could be reversible. Third, and most importantly, "knowledge" in s 41(1) of the FMA does not benefit from the expanded definition

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58 See for a useful discussion Yeats et al *Commentary 2008* 2-1085 – 2-1087.

59 See *Michalow v Premier Milling Co Ltd* 1960 (2) SA 59 (W) 62, and RD Sharrock "Insolvency" in WA Joubert et al *Law of South Africa* Vol 11 (2008) § 269 & n 3.

of the concept in the Companies Act, and thus knowledge in these instances would presumably not include constructive knowledge.[60]

However, s 41(3) of the FMA makes s 53(4) of the Companies Act applicable to an "entry" in terms of s 38 *or* 39 "with the changes required by the context".[61] Thus entries made despite supervening insolvency, though not mentioned in s 41(1) itself, remain protected, but in the same breath an expanded definition of "knowledge" in s 1 of the Companies Act rolls back the potential application of such protection.

In light of these provisions, one might ask whether finality of transfer makes the same degree of sense in the context of real security as it does for purchase and sale of uncertificated securities.

Where the real security is provided by means of a fiduciary cession *in securitatem debiti*, it is clear that the cessionary acquires the interest in question in an unqualified manner. Thus, finality of transfer operates unambiguously to protect the acquisition of that interest, such that the only recourse available for a cedent looking to reverse the cession as *sine iusta causa* would be liability in terms of s 55 of the Companies Act and perhaps also a claim of unjustified enrichment against the cessionary. Would-be cedents of uncertificated securities *in securitatem debiti* would, in this light, be well advised to be wary of structuring transactions in this manner. However, were one to follow the inclusive approach to s 39 as advocated for in the previous section, publicity of that cession would be achieved, as it would be flagged by entry at register-level (and in all likelihood in non-register level securities accounts as well).

However, in the context of pledge this question provides an opportunity to resolve some of the natural tension between the real nature of pledge and the protection of reliance effected by s 41(1) of the FMA and s 53(4) of the Companies Act respectively. It has always been clear that a pledge is of an accessory nature, and the existence of the pledge is contingent (as a point of departure) on the nature of the secured obligation. It has also been settled that the pledgee need not be a direct party

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60 Section 1 *viz.* "**knowing**", "**knowingly**" or "**knows**" of the Companies Act provides that:

"when used with respect to a person, and in relation to a particular matter, means that the person either—

(a) had actual knowledge of the matter; or

(b) was in a position in which the person reasonably ought to have—

(i) had actual knowledge;

(ii) investigated the matter to an extent that would have provided the person with actual knowledge; or

(iii) taken other measures which, if taken, would reasonably be expected to have provided the person with actual knowledge of the matter…"

61 Section 41(3) reads: "Section 53 (4), (5) and (6) of the Companies Act applies to an entry referred to in subsection (1) with the changes required by the context."

to the secured obligation (i.e. need not be the creditor),[62] but at the same time that, as per *Thienhaus v Metje & Ziegler Ltd*: [63]

> "a mortgage bond as a deed of hypothecation must relate to some obligation…If on a *concursus creditorum* a mortgagee, or a pledgee, fails to establish an enforceable claim which it was intended should be secured by the hypothecation, the bond or the pledge, as the case may be, falls away."

Here, the key issue in this regard is determining the appropriate balance to strike between the protection afforded a good faith outright transferee of a security on the one hand, and the protection the provision may afford a good faith pledgee on the other, in cases where their interests conflict. Specifically, the question is whether the principle of finality envisages the outright transfer of a security asset subject to any pre-existing pledge registered against it, or free from it:[64]

> "Where a pledge is noted, there is scope for debate as to what the consequence of a transfer by the cedent…in contravention of [what is now s 39(1)(b) of the FMA, requiring the cedent to obtain the written consent of the cessionary in dealing with her security] would be. Presumably, the transfer would, because of the contravention of such section, be illegal and therefore fall within the ambit of [what is now s 41(1)] and the protection extended to the good faith transferee. There is, however, a tension with [s 39(1)(b) and (d)] because usually a pledgee/cessionary would have a 'real' right to the subject matter…and the pledgor/cedent would not have the right to transfer the pledged [or ceded securities or interest in the securities]…It would appear from the entire uncertificated scheme, the intention is to elevate the importance of the subregisters and to uphold the integrity of the market by protecting good faith transferees and this may support [s 41(1)] trumping the common law position. In such circumstances, the pledgee or cessionary would no doubt have recourse against the participant. However, security is critical to business and financial structures and the credit worthiness of a participant may not be as good as the security of a pledge or cession *in securitatem debiti* bearing in mind, the securities could be worth billions of dollars."

This passage illustrates that considerations of commercial certainty and exigency (specifically the "integrity of the market") in the purchase and sale of uncertificated securities point towards very strong protections of finality of transfer in general, but may also do so in the context of the provision of real security. The argument that the fruits of recourse against a CSD or CSDP could be far outstripped by the value of the lost securities is particularly compelling.

Ultimately, the FMA itself provides a satisfactory answer.

In terms of the position of the good faith transferee, s 38(1)(b) of the FMA provides that:

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62 Badenhorst et al *Property* § 16.2.

63 1965 (3) SA 25 (A) 32.

64 Blackman et al *Commentary* § 91A, 5-237 – 5-238.

> “*(b)* The transferee of uncertificated securities or an interest in uncertificated securities referred to in paragraph *(a)* is entitled to all the rights of a transferee of movable property.”

On the position of the pre-existing pledgee, on the other hand, s 40 provides that:

> “(1) Despite any other law, if more than one interest or limited interest is entered against the same securities, priority must be granted to the interest or limited interest entered first in time in the securities account or central securities account, as the case may be.
>
> (2) *(a)* Despite subsection (1), the order of priority in any interest or limited interest may be varied by agreement between the parties.
>
> *(b)* Any variation referred to in paragraph *(a)* is not effective against third parties.”

Then, finally, s 41(2) qualifies its finality of transfer arrangements in the following manner:

> “This section does not modify the order of priorities determined by section 40.”

Despite the measure of flexibility in terms of how it can be structured, it should be regarded as axiomatic that the existence of a pledge must, by virtue of s 39(1), be reflected in the securities register. Thus, the term “interest” in s 40(1) must be read to include at least pledge and fiduciary cession *in securitatem debiti* as envisaged by s 39. The contrast inherent in the phrase “interest or limited interest” further suggests s 40(1) contemplates “interest” to include *all* forms of holdership than can manifest on the register, including instrument-holdership.

Take the following example: a specific nominee is reflected in the register as holder of the security-instrument and a specific pledgee in respect of the security is also reflected on the register. The register shows the latter was registered at a later date than the date of acquisition of the security-instrument. This allows one to ascertain that the extent of the interest of the asset-holder (who will be evidentiarily reflected somewhere in downstream records, but is represented on the register by the instrument-holder) is limited by the extent of the pledge. Thereafter a third party takes transfer of the security without written consent of the pledgee, such that *quasi*-delivery to her chosen instrument-holder is reflected on the register at a later date than the date associated with the pledge.

Section 41(2) would thus provide that the order of priorities determined as per s 40(1) remain unaffected and the transferee instrument-holder will (despite any fraud, illegality or insolvency) obtain an interest that is qualified to the extent of the prior registration of the pledge. That means the acquiring downstream asset-holder will also only obtain the extent of the security asset which was (*quasi-*)delivered – i.e. the security asset as encumbered by the pledge.

This position is also supported by the terms of s 38(1)(b), which confirms that any acquirer is “entitled to all the rights of a transferee of movable property”. A transferee of movable property would, all other things being equal, have to take *constructive delivery* of the thing because possession would be with the pledgee and, by analogy, a similarly limited form of *quasi*-delivery would have occurred in terms of the example above.

9 2 Other limited real interests in securities

With a more sophisticated and accurate understanding of the law as it relates to limited real rights of pledge in respect of securities, as well as a clear meaning to the second possible usage of "interests in securities", all that remains is to discuss real rights other than pledge, or rather other interests in securities as meant throughout the rest of this work.

A good example of both the practice and the concomitant theoretical problems can be found in the following statement:[65]

> "Under English law it appears that any number of equitable interests can be carved out of the equitable ownership of a share. This is presumably based on the English dual ownership construction where the beneficial interest in the shares held in trust by a nominee is regarded as divisible. The preferred view is that South Africa has not imported such dual ownership into its property law, and, accordingly, there may not be the same scope for divisibility under South African law. Nevertheless, it is generally accepted that shares can be purchased with dividend *(cum* dividend) or without dividend *(ex* dividend). As a result of a *cum* dividend purchase the purchaser acquires the right to dividends declared after the date of sale, i.e. he can claim these dividends even though he was not as yet registered as a shareholder of the company at the time when they were declared. Where there is no express provision to the contrary in the contract of sale, the sale is deemed to be *cum* dividend in respect of dividends declared after the date of the sale."

Nonetheless, the discussion here will be restricted only to one kind of real interest – the personal servitude. The emergent principles of a discussion of personal servitudes, specifically the *usufruct*, should be sufficient to illustrate the most cogent aspects of the broader theoretical position suggested here, including phenomena such as that of sale *ex* (or even *solo*) dividend. The first portion of this discussion will relate to the nature of the right and interest; thereafter, personal servitudes in respect of certificated and uncertificated securities will be discussed respectively.

A personal servitude is so named as it operates in favour of a specific person, rather than merely against the specific asset in question. Thus these servitudes are inalienable and cannot devolve,

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65 Yeats et al *Commentary 2008* 2-826, see also 2-1072 – 2-1074.

and end either at the occurrence of a specified date or condition, or death of the holder (for juristic persons, who do not die, a limitation of one hundred years applies).[66]

Though best known for their specific sub-species *usus*, *fructus* and *usufructus*, personal servitudes are in principle entirely variable in subject matter. This is most often expressed in respect of praedial servitudes, but is equally applicable to their personal counterparts:[67]

> "While the three servitudes of usufruct, use and habitation are generally regarded as personal servitudes *par excellence*, it must nevertheless always be remembered that personal servitudes may confer a vast variety of other entitlements and benefits on their holders, and, in particular, that *most "praedial servitudes" may also be constituted as personal servitudes*."

Whilst Roman law knew only a *numerus clausus* of personal servitudes, the more abstract South African property law does not. Aside from the usufruct and its lesser variations, a number of "*servitutes irregulares*" have specifically been recognised in the past, including the entitlement to trade on a specific piece of property, install and exploit a railway side-track, lay electricity cables or log an area of land and remove the lumber.[68]

This is key. Embedded in the theoretical framework of this work is the notion that whilst the components of the creditor's interest are two-fold (the entitlements of execution and enjoyment, respectively), the incident-functionalities which can be derived from holdership of these entitlements, especially of the latter through asset-holdership, are numerous and entirely variable. This is because an incident-functionality arises from the *exercise of* legal subjectivity over that interest, which accords with the more general principle that servitudes are variable in form and content.

Accordingly, in South African law, the establishment of servitudes is principle- rather than case-driven for things as well as (at least) securities as incorporeals. Under this discussion, the exercise of legal subjectivity over the security asset, when exercised in a certain specific way, can objectify such an incident, or set of incidents, and make it subject to a limited real right.

The specific incident or set of incidents that are to be made subject of a particular personal servitude would therefore be revealed through how it is constructed through the actions and intentions (i.e. exercise of legal subjectivity) of the provider and receiver of the servitude. In constructing the

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66 Van der Merwe *Sakereg* 360 & 366, and Badenhorst et al Property § 14.2, 322 & § 14.4.1, 338-339.

67 See Badenhorst et al *Property* § 14.4.2, 342 & n 183 [own emphasis]; see also the following statement at § 14.1, 388 (citing, in n 4, *Lorentz v Melle* 1978 (3) SA 1044 (T) 1050–1051):

> "[Historically recognised] types of restrictions [on the types of servitudes] have been relaxed to such an extent, at any rate in regard to praedial servitudes, that their number is "practically unlimited" although certain general requirements have to be fulfilled."

68 See Van der Merwe *Sakereg* 360-361 & n 324-327, and Badenhorst et al *Property* § 14.4.2, 341-342 & n 183.

servitude, the principle-based legal requirements for the establishment of the real right with that incident or set of incidents as object must of course be adhered to. Thus "[i]n the final analysis…any doubts as to whether or not a right is a servitude in any given case will have to be resolved by reference to the principles which determine the nature of a real right as a protected interest."[69] This is dealt with below when discussing the contexts of certificated and uncertificated securities respectively.

However, before each can be dealt with, it must be determined whether the construct of a personal servitude, or that of a personal quasi-servitude, is the most accurate. This distinction has important consequences. To facilitate the analysis, the content of the usufruct will be discussed. From a policy perspective, the social and economic function of the construct is to provide a person (often a testamentary beneficiary) with income from an asset or assets (even entire estates) without ownership.[70] Because a servitude, personal or praedial, confers "a real right to an advantage out of the property of another",[71] it is assumed that ownership of the asset (property)[72] in question remains with the provider of usufruct or her heir or heirs. The beneficiary is provided with the ability to use the asset (*usus*) and to reap, use and enjoy the fruits (*fructus*) of the asset for the duration of the right. A duty to return the asset with its essential character and quality intact (*salva rei substantia*) upon the termination of the usufruct, also arises from its creation and bestowal.[73]

The question of the full servitude versus *quasi*-servitude arises in the context of assets which, according to the principles of property law, are to be regarded as *consumable.* CG Van der Merwe, whose work on the first principles of South African property arising out of its common law sources is of great value here, describes consumable things as follows:[74]

> "*Verbruikbare sake is sake wat, indien hulle volgens hul gewone bestemming gebruik word, deur sodanige gebruik verbruik word of aansienlik in waarde verminder, byvoorbeeld lewensmiddele, wyn, olie, kerse, en sigarette. Volgens sommige skrywers sluit dit ook verslytbare sake soos klere en meubels in wat nie deur gebruik geheel en al tot niet gaan nie, maar so verval dat dit nie meer vir hul oorspronklike doel gebruik kan word nie. Onverbruikbare sake is bestem om tydens die gebruik daarvan in stand te bly. Voorbeelde hiervan is 'n grondstuk, 'n motor, boeke, skilderye en ringe.*

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69 Badenhorst et al *Property* § 14.1 321 & n 5.

70 Van der Merwe *Sakereg* 360 & 362; see also *Garmany NO v Templeton's Executors* 1936 SR 139, 161.

71 *Dreyer v Letterstedt's Executors* (1865) 5 88, 99; as per Badenhorst et al Property § 14.1, 321 & n 1.

72 Which may be immoveable, moveable, corporeal or incorporeal – Badenhorst et al *Property* § 14.4 339 & n 156-158.

73 Van der Merwe *Sakereg* 360-361; Badenhorst et al *Property* § 14.4 339-340; CG Van der Merwe & MJ de Waal "Servitudes" in WA Joubert et al Law of South Africa Vol 24 (2 ed) 2010, § 581-583 & 591; and *Fourie v Munnik* 1919 OPD 73, 79.

74 Van der Merwe *Sakereg* 34-35.

…Geld word ook as 'n verbruikbare saak beskou en word geag verbruik te wees indien dit uitgegee is of met ander geld op so 'n wyse vermeng is dat die bepaalde muntstukke of note nie meer identifiseerbaar is nie."

Consumable goods, such as grain, cannot be used and enjoyed and nonetheless returned *salva rei substantia*. It follows that they cannot be made subject to a usufruct. Money, due to the fact it can be subject to transfer of ownership by commingling, is treated in the same fashion. Thus, from Roman times onwards, a quasi-usufruct construct was recognised to fulfil the same social and economic function with respect to these consumable assets.[75] Importantly, the underlying mechanics of the quasi-usufruct construct works very differently to the usufruct. Due to the consumable nature of the asset or assets, a quasi-usufruct *transfers ownership to the beneficiary*, together with a concomitant duty to return an asset or assets equivalent (though seemingly not necessarily perfectly identical) to what was received. For the duration of the right, the quasi-usufructuary may use and enjoy the asset, and receive any fruits (e.g. interest payments) which the asset may yield.[76]

On that basis the quasi-usufruct, and indeed all personal quasi-servitudes, appear similar to the fiduciary cession *in securitatem debiti*. Thus, the real nature of the quasi-usufruct appears open to question – is it not rather a mere personal right to cession or transfer in equivalence to the original cession or transfer? Nonetheless, this work will assume its real nature in line with the authorities it makes use of.

By extension of the quasi-usufruct over money, it became accepted that a quasi-usufruct may be granted with respect to a personal right.[77] The beneficiary of a quasi-usufruct to performance receives the benefits of performance and may similarly put to use the results of performance to garner further fruits. Where the performance is owed in money – i.e. in cases of a debt – the usufructuary may claim interest where performance is tenderable over time or at a later date. Thus:[78]

"[t]he usufructuary may call in the debt and invest the money for interest, but the capital sum must be made good when the usufruct expires…At the end of the usufruct, the proceeds must, after deduction of expenses, be restored to the nude owner."

This implies that a claim to performance is a *consumable* thing. Broadly that makes sense – it is trite that "use and enjoyment" of performance extinguishes the obligation in terms of which performance

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75 See Van der Merwe *Sakereg* 362-363; CG Van der Merwe "Regsbegrippe en regspolitiek" (1979) 42 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 9, 15; Van der Merwe & De Waal "Servitudes" in LAWSA, § 584; and *Geldenhuys v CIR* 1947 (3) SA 256 (C) 260.

76 *Geldenhuys v CIR* 1947 (3) SA 256 (C) 260-261; Van der Merwe & De Waal "Servitudes" in LAWSA, § 584; and Van der Merwe *Sakereg* 363.

77 Leos (2006) *SALJ* 132.

78 Van der Merwe & De Waal "Servitudes" in LAWSA, § 584; see also Van der Merwe *Sakereg* 363 & n 340.

was tendered. What does that imply for personal servitudes granted with respect to securities? The current authority is *Cooper v Boyes*.[79] This case revolved around shares, but it is equally useful for both debt and equity securities. The court, after an extensive and exhaustive discussion of the relevant common law, academic authorities and relevant company law principles, held that the underlying nature of the rights and other competencies of shares did not warrant their classification as consumable goods. As per the court:[80]

> "it is clear that there is no simple definition of a share. The various definitions emphasise a complex of characteristics which are peculiar to it. The gist thereof is that a share represents an interest in a company, which interest consists of a complex of personal rights which may, as an incorporeal movable entity, be negotiated or otherwise disposed of. It is certainly not a consumable article, such as money, even though a money value can be placed on it. Nor can it, by any analogy, be likened to a debt which may give rise to a claim of some kind or another, even though the debt and related claim may eventuate in an award of money being made to the claimant in respect of such debt.
>
> The fact that the value of a share in a company may fluctuate for a great variety of reasons, or that it may be affected by all manner of eventualities which may befall the company, such as liquidation, cannot change its essential nature. It cannot, by any stretch of the imagination, be converted from an interest or conglomerate of personal rights into an article which will be consumed by its very use and enjoyment.
>
> There is, of course, no reason why it cannot be bequeathed by way of a usufruct. The usufructuary will have the right to receive dividends or other benefits accruing to the share, subject thereto that, on termination of the usufruct, the share itself must devolve upon the heir as ultimate beneficiary in whom the ownership thereof vests."

Although this has been subjected to criticism,[81] the principle appears sound. It also seems to have been well received,[82] and it is submitted that it should be accepted as a correct point of departure.

The issue that it raises, however, is whether a similar pronunciation may be made of debt securities. This hinges on whether a debt security is to be regarded as consumable or not.[83]

This question is more difficult than it seems. Unlike shares, debt securities' operative lifetime is fixed. Debt securities may further, depending on how they are structured, diminish in value as they bear fruits (coupon payments). Yet one can similarly argue that sheep or cars, which are not regarded as

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79 1994 (4) SA 521 (C).

80 535B-G. See also Van der Merwe & De Waal "Servitudes" in LAWSA § 584 n 2.

81 See Leos (2006) SALJ 126.

82 Leos (2006) *SALJ* 130.

83 See *Geldenhuys v CIR* 1947 (3) SA 256 (C) 263, which held that sheep are not consumable and subject to a usufruct proper.

consumables, also have an essentially fixed lifespan and diminish in value through use. Indeed, corporeal assets are subject to depreciation. In a broadly similar manner, debt securities and other loans are subject to the equivalent but financial concept of amortisation. On the face of it, it seems strange that a car may have an operating lifespan of approximately ten years and be considered non-consumable, but a very expensive bottle of whiskey with an indefinite operative lifetime is considered consumable. Certain whiskeys may even appreciate while the value of cars typically depreciates.

On the other hand, cars and sheep: (1) can be used iteratively throughout their operative lifespan, and (2) each instance of use does not markedly diminish its essential character and value. Once a bottle of whiskey is opened: (1) it can be used iteratively throughout its operative lifespan, but (2) each glass consumed will diminish its essential character and value by a very large measure. Nonetheless even this feels arbitrary, as it seems to hinge on *rate of decay*, rather than *decay itself*, through use and enjoyment.

It is readily admitted that the above examples are cherry picked and that a great number of things are clearly consumable or not. What the above is meant to illustrate, however, is that examples do exist where the distinction is not as clear, and the ordinary metric of fundamental change or significant degradation through use and enjoyment is not the lodestar it purports to be. The ultimate aim is further to show that *debt securities* are a part of this category of more ambiguous instances. Could time, value, or value over time be a consideration in the determination of consumability (and thus in classifying debt securities using the distinction in *Cooper*)? It is possible, but such a variable approach, even if rooted in *rate* of decay, does not solve the essential lack of legal certainty, because the determination remains essentially subjective.

It is submitted that there is a better way to analyse whether *Cooper* is correct in classifying debts as consumable.

It is trite that a usufruct over the aforementioned car or sheep would entitle the usufructuary to drive the car or shear the sheep. Yet it would also entitle the holder to profit off, for example, a taxi service with respect to the car, or selling the wool of the sheep. This illustrates the distinction between *natural* and *civil* fruits. The former are natural (valuable) outflows of the thing, such as the literal fruits of an orchard; the latter indicate income generated through (profitable) juristic acts committed with respect to the thing.[84]

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84 "[D]ie reëlmatige, natuurlike voorbrengsels van die saak" in contrast to "die reëlmatige inkomste van die saak wat ingevolge regshandelinge met die saak verkry is" – Van der Merwe *Sakereg* 364-365.

However, with regard to the whiskey the situation may be different. Through prudent economic action one may generate civil fruits from it, for example by selling tickets to a tasting. But is drinking the whiskey truly the use and enjoyment of its natural fruit, or use and enjoyment of the substance of the whiskey itself? Is it not more accurate to state that the whiskey generates no natural fruits, because its use or enjoyment of its substance is indistinguishable from the destruction of that substance? It cannot "naturally produce" anything separate from itself, whether tangible or intangible. The same could be said of oil or even grain. To use and enjoy these items is to destroy either them or their essential character, and only by taking prudent and profitable economic action with respect to their destruction (convert oil into petrol, or plant grain in soil) is one able to make them produce fruit. Any such fruit will clearly be *civil* in nature.

On that basis, because destruction is: (1) in the technical legal sense a form of disposal, and (2) unavoidable in the process of use, enjoyment, and the generation of civil fruits, it follows that whilst disposal of the asset underlying a usufruct is unlawful, disposal of the asset underlying a quasi-usufruct is *implied*. Put differently:[85]

> "[t]he *ius abutendi* cannot be conferred on a usufructuary...a proper usufruct is not possible over any property which, when used for the first time in the normal way, changes in substance, is extinguished or is readily consumed by use, such as oil, grain, food, money or cigarettes. In the case of such property there can be no meaningful distinction between the *ius utendi* and the *ius fruendi* (the right of use and enjoyment) on the one hand and the *ius abutendi* (the right of abuse or destruction) and the *ius dispondendi* (the right of disposal) on the other hand."

If in this context disposal and consumption are functional equivalents, may a quasi-usufructuary not only destroy the asset, but also profitably alienate it in order to reap civil fruits? The answer must be in the affirmative because they amount to the same thing. The transfer of ownership is, and indeed must be, required in the quasi-usufruct construct in order to enable the use and enjoyment of civil fruits, and conversely civil fruits can be generated through destruction or profitable alienation.[86]

What does this analysis bring to the context of securities? It points to the *viability of a right to use and enjoy the natural fruit* as a leading metric of distinction between consumable and non-

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85 Leos (2006) *SALJ* 132.

86 See A Apers & AL Verbeke "Modern usufruct – empowering the usufructuary" (2014) *Journal of South African Law* 117 § 4, 123-124.

consumable securities. It is – mostly[87] – uncontentious that shares produce natural fruit, and this metric is the simplest and most elegant reason that can be offered as to why they are not consumables, despite being mainly constituted of obligations and thus bearing fruit through performance.

What about debt securities? As shown above, a debt seems (as a point of departure) to be regarded as consumable, and thus subject only to the *quasi*-usufruct. It is submitted that despite its common law support, this is not necessarily a sound view when dealing with all debts, especially when dealing with debt securities. This is because debts do not resemble other personal rights, or money, in the ways that matter.

Claims to (single or iterative) performance not tenderable in money do not typically attract any interest – performance simply occurs when it is due, after which the (or each successive) obligation is extinguished. Non-monetary performances are thus in all likelihood correctly regarded to be consumable. Physical money, on the other hand, also does not attract interest and is subject to commingling, making ownership of money tenuous. By reason of that fungibility coupled with its primarily possession-based usefulness, money is also correctly considered consumable through spending or mixing.

Debt, however, may be different. The manner in which debt, and debt securities, can be structured is very different to other claims to performance. Debt typically consists of a capital sum loaned *and* interest, and consists of iterative obligations of repayment over an agreed upon period of time. When the capital sum lent is repaid, the recipient of those payments could perhaps be said to be consuming that asset. Yet it is difficult to accept that receiving interest payments amounts to consumption of the asset – they appear more akin to the natural fruits of the asset over its serviceable lifetime. Indeed, it is trite to state that interest is *fructus* on the principal sum lent. Even in the absence of provision for interest, debt in arrears will attract moratory interest.[88] Thus, following the earlier-proposed

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87 As per Leos (2006) *SALJ* 135-138, this thinking is not entirely uncontentious in the context of shares and the quasi-usufruct as outlined in *Cooper v Boyes*. The opposite view hinges on complexities in the nature of shares and of companies to argue company distributions are difficult to classify as natural fruits. Yet this view is mistaken. Principally, the argument states that any determination of what "state" of shares should be regarded *salva rei substantia* is, irrespective of the ultimate legal nature of a share, not a practical or even sensical proposition.

But a company is an organic and dynamic legal phenomenon, so that arguments relating to complexities of company law and the nature of the juristic form do not provide a viable argument for why the decision in *Cooper v Boyes* is incorrect. *Salva rei substantia*, it is submitted, need only be *ascertainable* and not certain. Thus a more elegant, and effective, explanation is simply to regard distributions made by a company to its shareholders as *natural* fruits of those shares, and accordingly to state that the return of the right to use and enjoy natural fruits (to the nude asset-holder) is an adequate return of the asset *salva rei substantia*. In fact the potential immortality of juristic personality makes share-based distributions a possible *perpetuity*, and as such theoretically inexhaustible.

Other arguments relating to the potentially misapplied distinction between consumables and fungibles is also unconvincing, by mere reason that fungibility relates the *replaceability*, which is neither here nor there in the context of the obligation to provide an asset or assets *equivalent* rather than identical.

88 As per the Prescribed Rate of Interest Act 55 of 1975 and *Katzenellenbogen Ltd v Mullin* 1977 (4) SA 855 (A).

metric, the right of use and enjoyment of the natural fruits of debt is indeed viable. Could this be grounds for classification of debts as a durable, rather than consumable, asset?

It is submitted that under the right circumstances, the answer must be in the affirmative. Considering the myriad different ways debt (and consequently debt securities) can be structured,[89] it can be quite difficult to determine with certainty whether the creditor is receiving fruits, or consuming the capital sum, or to what extent a combination of both is occurring.

Debt securities, specifically, best embody this ambiguity. Debt securities appear to be a structured, "commoditised" complex of rights and other competencies providing patrimonial gains *over time*. First, they can have what can rightly be referred to as a useful lifetime. Second, their intrinsic value may increase (e.g. discounted zero coupon bonds), decrease (e.g. vanilla bonds issued at face value) or even fluctuate (e.g. junk bonds in the right environment) over their useful lifetime, (which will, generally, be tracked by their price in the marketplace). Third and most importantly, their interest and capital may be payable together in fixed or floating coupons, or payable in a specific order despite a constant coupon (e.g. capital interest first and thereafter), or capital and interest may be paid at wholly separate intervals (e.g. interest during the term and capital at the end). They are bought and sold as (typically) depreciating assets.

In this light, would it not be more sensible to suggest, as a point of departure, that the diminishing value of a typical debt security, as amortisation of the income receivable, be seen as more similar to the diminishing value of a movable, quasi-fungible corporeal asset? Could it not also be said that interest is as natural an outflow of a debt security as the usefulness and enjoyment derived from driving a car? If so, a debt security could very well be a durable asset.

Yet according to *Cooper v Boyes*, it is not:[90]

> "On the question of usufruct of debts, however, Van der Keessel…qualifies the opinion of Voet, mentioned above, that, when a debt is given in usufruct, it is regarded that the money to be claimed under such debt is in fact the object of a quasi-usufruct. This is not acceptable, he says, when it relates to claims which have been granted on interests. The usufruct of such interest (*ususfructus calendarii*), Van der Keessel suggests, appears to be a true usufruct:
>
> > *'Sed hoc quidem de nominibus faenori datis non videtur accipiendum, hic enim ususfructus calendarii…videtur verus esse ususfructus…'*

89 The various ways in which debt can be settled are too complex to discuss here. Suffice to say repayment can occur in successive payments over time, or can occur in one lump sum at the end of the term, and that successive repayments may represent only capital, only interest or a discounted combination of the total of both.

90 1994 (4) SA 521 (C) 531E-H.

> It is not necessary to go into Van der Keessel's explanation of the aforesaid qualification since it does not appear to be supported by any other authority available to me and may even be considered somewhat pedantic."

Nonetheless Van der Keessel's argument has great merit. Should the capital sum be the object of the right, the use and enjoyment of its natural fruit is not viable, as that is tantamount to its disposal. An obligation on the part of A to pay B R100 000 one year after it has been lent is certainly consumed when the amount is paid.

Should the object of the right be only the interest, or both interest and capital, rather than the capital sum only, the position may be different. When pure interest is to be used and enjoyed in terms of the right, it patently has no effect on the substance of the debt. Thus the object of the usufruct simply must be regarded as durable. When a debt is repaid over time in a manner where each repayment is a portion of both the interest and the capital, the lifetime of the debt and the *rate* at which the debt reduces should determine if the analogy of using a car better fits the arrangement than that of burning oil, eating grain, or drinking whiskey.

A second, equally important, argument to complement Van der Keessel's stance is that the commercial reality has probably outgrown the origins of the quasi-usufruct approach to debt. Subjecting a debt to the quasi-usufruct construct is largely based on the premise that the *money* receivable in terms of the claim is the object of the right. As money is subject to the quasi-usufruct construction, so is debt; or according to the court in *Cooper*:[91]

> "In accepting the Roman legal principle that debts (*nomina*) should also be numbered among consumable things, Voet…explains that such debts should be equated with the money which can be claimed when they are sued upon:
>
> *'Caeterum uti in auro, argento, aere, oleo, frumento, vino similibusque, ac in ipsa numerata pecunia quasi usumfructum constitui indubitati juris est…ita in nominibus quoque eundem admitti, post jurisconsultorum varietates obtinuit…in quantum nomine in usumfructum dato, pecunia ipsa data intelligitur, quae ex tali nomine venit exigenda…'*
>
> ('For the rest, just as it is undoubted law that a quasi-usufruct is constituted in respect of gold, silver, bronze, oil, grain, wine and similar things, and likewise in respect of coined money itself, just so, after differing opinions obtained among jurists, it was applied equally to debts: so to the extent that a debt is given in usufruct, it is regarded that the very money, which comes to be claimed on such debt, has thus been given…')."

A critical flaw in this analogy is that, in the modern world, debt is no longer typically paid in money, but rather presents as a personal right against a financial institution (primarily banks) to make those

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[91] 531.

funds available to the creditor and deduct those funds from the debtor's available balance. Debt is payable in debt, not money. The *quasi*-usufruct with respect to money exists to address the *fungibility and expendability* of money and the consequent effects of consumption through use or commingling. That imperative is not present with regard to debt, as in most cases "who is owed what" is meticulously accounted for through the national payment and banking systems. Bank balances are not, after all, subject to commingling.

Natural fruits, by definitional logic, do not cause the essential substance of an asset to deteriorate any more than it naturally would – for instance, a fruit tree is not considered to be consumable. By the same reasoning, interest on a debt is the natural fruit of that debt. If the position of the current authorities is to be accepted this is a very curious scenario – an ostensible consumable which yields natural fruits. In this light, the extension of the *quasi*-usufruct to personal rights due to the analogy with money does not appear as clear cut as it has been accepted to be.[92]

Now that the contextual ambiguity of debt as a consumable or durable has been established, it becomes clearer that a resolution must be sought in a return to first principles. From the preceding section, the first principles are also far clearer. Limited real interests in securities, such as pledge, are created (and function) at the level of incidents. The nature of the incident or set of incidents that serve as object to the right will determine the nature of that right.

From the above, it initially appeared that debt may be durable or consumable, depending the outcome of "viability of natural fruit" test. But that is to misread the underlying position. In line with Chapter 4, as well as the modern nature of debt and money, the true position is that *the incident functionality or set of incident functionalities that serves as the object of the usufruct may, depending on its nature, be durable or consumable.* Because the level of incidents is driven by action – i.e. the exercise of legal subjectivity – it is dynamic, rather than static. This is also, incidentally, why the doctrine of subjective rights fails properly to account for phenomena such as limited real rights to obligations: it is too static.

Although the object of a usufruct appears to be naturally limited to the right of use and enjoyment, it follows that that which is to be used and enjoyed may be variable. In respect of debt securities it can refer to: (1) the principal debt or a portion thereof, (2) the interest or a portion thereof, or (3) both interest and capital or a portion thereof. A "portion of" may further be determinable with reference to time (pointing to a durable object), or value (pointing to a consumable object).

Thus, the ultimate position is as follows. Where a right of use and enjoyment over an incident or set of incidents of a debt security entails the use and enjoyment of natural fruits, that right of use and

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92 Leos (2006) *SALJ* 132.

enjoyment is a usufruct. Where the use and enjoyment of natural fruits are not viable in the exercise of such a right, it is a quasi-usufruct.

To conclude this discussion, consider three different debt securities. Debt security A is a security issued at face value for R500m, with a yield-to-maturity of 10% over a lifetime of five years. Each quarterly coupon payment is a mixture of interest and capital. Debt security B is issued at 61,4% of its face value of R500m, i.e. R307m, and it does not pay any coupons over its five year lifetime. It also has a 10% yield-to-maturity. Debt security C is issued at a face value of R100m, also with a five year term and yield-to-maturity of 10%, but its quarterly coupon payments cover only interest, and the R100m is repaid in one lump sum on its termination date.

Debt security A diminishes in value over its five year lifespan and provides twenty identical payments before it is extinguished. Debt security B increases in value, but provides no payments until its expiration, at which point it provides payment of interest and capital in full. Debt security C diminishes in value as its interest is repaid, but its capital amount is not consumed over its operative lifetime. The nature of the personal servitudes which can be granted over these securities are different and varied. The above seems to point to the fact that the structure of the usufruct (as evidenced by the intent of the parties, the surrounding factual matrix and the manner in which effective control is bestowed to perfect the right) will determine its durability or consumability, as the case may be.

With this in mind, one may now turn to the far simpler mechanics of granting these rights with respect to certificated and uncertificated securities respectively.

9 2 1 Certificated securities

The case of certificated securities is simple, because a distinction has now been properly made between the debt on the one hand, and the incident or set of incidents which may serve as the object of a usufruct in respect of a debt security. Here it is key to remember that, unlike corporeal things, various incidents of incorporeal assets may be subject to the simultaneous effective control – i.e. *quasi*-possession – of more than one person.

Where it is clear that the concept of natural fruits is not viable for such an object, the right is a *quasi*-usufruct and full holdership over that object must pass to the *quasi*-usufructuary alongside the appropriate degree of effective control over the instrument-holder.

Where natural fruits appear viable, the ordinary rules of usufruct apply and effective control over the instrument-holder with respect to that object will – together with the requisite real intent – suffice. The creation of a usufruct over the interest payments of a debt security which is viable for such a construction is also a simple matter, as the creation of all limited real rights in respect of certificated securities may follow the same proprietary principles set out in Chapter 4, most importantly § 4 3 2. This was fully discussed in § 9 1 1 above.

In summary it can be described as follows. Where an asset-holder wishes to isolate an incident-functionality or set of incident-functionalities, and make it subject to a limited real right in favour of a third party, she must: bestow *lawful effective control* over that incident or set of incidents to the party in whose favour the right is to function, doing so with the requisite form of real intent.

Using the example of security C above, the asset-holder must provide control over the instrument-holder (i.e. control over the "executer") in respect of all coupon payments save the final payment, and the two parties must have the corresponding intent to give and receive the personal servitude as real right. The various ways in which this can be done has also been fully canvassed in § 6 1 2 1, but due regard must be had to the *nature of the incident-functionality* in question (as object of the real right) to ensure that the right is adequately constituted.

9 2 2 Uncertificated securities

Uncertificated securities pose a slightly more vexing question and brings one back to the meaning of "an interest in an uncertificated security" as found in the FMA.

As was learned in § 5 2 of Chapter 5, the *direct* (and sometimes allocated) nature of holdership of the South African settlement system under the FMA makes it clear that the international concept of "interests in securities" cannot manifest in the domestic environment. Even where securities are immobilised in the true sense, the central securities account of the CSD indicates the notional bearer of the security and such securities would most likely function as registered securities do.[93]

Nevertheless, to recap some of the work in the previous section, s 38(1) of FMA reads:

> "[t]he transfer of…an *interest in uncertificated securities* on the uncertificated securities register held by a central securities depository or participant must be effected in the manner provided for in Chapter 2, Part E of the Companies Act, where applicable, and the depository rules, *by making the debit and credit entries respectively* in the central securities account or securities account of the transferor and the transferee kept by the central securities depository or the participant."

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93 Even s 1 *viz.* "deposit" indicates this, reading "**'deposit'**" means a deposit of securities, and includes a deposit by means of an entry in a securities account or a central securities account…"

The FMA also seems to contemplate the registration of limited real interests, as evidenced by s 36(2)(a)(ii) of the FMA:

> "(3) (a) No central securities depository or participant may become the owner, co-owner, holder, pledgee or cessionary for the purpose of securing a debt, of securities merely because of—
>
> …
>
> (iii) the registration in its name of—
>
> (aa) securities;
>
> (bb) limited rights in securities;
>
> (cc) other rights in securities;
>
> (dd) benefits in respect of securities; or
>
> (ee) benefits accruing to securities."

Section 37(2) seems to acknowledge that "[i]n so far as any limited right exists in respect of any securities at the time of…deposit or accrual, such limited right extends to the interest of such co-owner and to any securities delivered to that co-owner." Section 51(5)(b) of the Companies Act, included by reference in s 53(3), and thus part of the FMA by virtue of s 38, also contemplates "the description of the securities, or interest transferred…".

Most importantly, there are the terms of s 40 of the Act:

> "40. **Ranking of interests in securities** – (1) Despite any other law, if more than one interest or limited interest is entered against the same securities, priority must be granted to the interest or limited interest entered first in time in the securities account or central securities account, as the case may be.
>
> (2) (a) Despite subsection (1), the order of priority in any interest or limited interest may be varied by agreement between the parties.
>
> (b) Any variation referred to in paragraph (a) is not effective against third parties."

However, if "interests in securities" is taken to mean limited real rights in respect of securities, there is a significant problem regarding their creation within the scheme of the FMA. The problem, ironically, is real security. The pledge or limited outright cession of one or more specific incident-functionalities *in securitatem debiti* is done in accordance with s 39 of the Act. The methodology prescribed is clear: the pledgee or limited cessionary must be entered *alongside the instrument-holder* in the applicable securities account. Thus, one might say only a credit is required, without any corresponding debit. That methodology, sensible though it is, is limited in terms of s 39 to acts (other than out-and-out transfer of the security) that are aimed at providing real security.

Accordingly, all other limited interests in uncertificated securities must be bestowed in accordance with s 38, which – if given a plain language interpretation – requires a debit and credit of the respective securities accounts. This implies, like an outright transfer of the security asset, that quasi-delivery in the form of a transfer of the *security instrument* is required. Yet this does not quite make sense. It is submitted that there are four ways of approaching this problem, none of which are particularly satisfactory.

The first is to assume that a limited real interest other than a pledge or limited cession *in securitatem debiti* can only be created through an agreement making the limited interest-holder the instrument-holder. Thus, a debit and credit takes place in the applicable securities account, satisfying both the quasi-delivery and effective control requirements in the creation of the limited real right. On the patrimonial level, the asset-holder remains asset-holder, but the instrument-holder also has a limited beneficial interest in the security, for example: (1) for a viable debt security, the right to enjoy the *natural* fruits of the debt, or (2) for a share, a full *usufruct* over the security. However, the key issue with this method is that it renders s 40 of the FMA ineffective except in so far as s 39 is concerned, as there will be no formal record of the nature of this limited real interest in the security in the securities account – merely a record of a new instrument-holder.

The second is to assume that the intention of the legislature was to effect the granting of all limited real interests in securities in the manner provided for in s 39. This then leads one to a purposive interpretation of s 38, whereby one must bend the language of the statute somewhat to allow only a credit to the securities account of the grantor of the personal servitude, such that it reflects the names of the instrument-holder and the limited real right holder. Despite being a non-literal reading of s 38, this approach accords with s 51(5)(b) of the Companies Act and sections 36(2)(a)(ii), 37(2) and 40 of the FMA.

The third way is to accept that, barring the implicit statutory requirements imposed on the granting of real security, all limited real interests in securities occur *outside of the framework of the FMA*. As no direct provision for this is made, it could be argued that "limited interests in uncertificated securities" refers only to rights of real security and all other limited real rights are a matter *inter partes* between asset-holder, instrument-holder and grantee of the right in question. In this case the security of transfer protections of s 41 of the Act are not available to these kinds of limited interest holders, and ss (2) of that section only applies to holders of real security as reflected in the priority established by s 40.

The fourth is to assume that a debit and credit is necessary, but that the record of the limited real interest must nonetheless be reflected in the applicable securities accounts. By this interpretation, all the provisions of the Act can be satisfied, but at the cost of considerable practical inelegance. In terms of this approach, a first debit and credit will transfer the entirety of the security-asset to the grantee of the right in accordance with the principles of § 6 1 1 2 above. However, the details of this transfer in the securities account will specify the nature of the limited real interest. Thereafter, a second debit and credit will transfer the security asset back to the grantor of the limited interest, but the original entry in favour of the grantee will remain, such that both grantee and grantor will have entries in their respective securities accounts reflecting the extent of their interests in the particular security.

However, in the final analysis, this issue is of very limited application in the context of debt securities. Thus, no final determination will be made here about which method, or combination of methods, is correct or viable, although the outcome of a such an analysis is of far greater importance in the context of shares.

CHAPTER 10

10 Good faith acquisition of debt securities

In Chapter 8, the requirements for the acquisition of securities, through transfer and transmission, were re-examined and clarified in light of the outcomes of Chapters 4 and 5.

For both certificated and uncertificated securities, the law also affords measures of protection to a good faith transferee of security-holdership despite the fact that the transfer is legally defective. In the context of certificated securities, this protection is limited to the defence of estoppel by representation,[1] best confirmed in *Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd*.[2] In the context of uncertificated securities, the protection is afforded by s 53(4) of the Companies Act and s 41 of the FMA (which provisions offer a protection far more widely effective and available than that of estoppel).

Due to the fact that neither the policy basis nor the purpose and effect of these mechanisms is perfectly identical, it is better to deal with each separately. Common to each, however, is the fact that the protection of a legally defective but good faith acquisition of a security may well serve to override various legal mechanisms which exist to protect the true holder of a security, or a limited real interest in a security (which protections are more fully discussed in Chapter 11 hereafter).

Before these certificated and uncertificated contexts can be discussed, one must deal with what the protection of good faith yet defective acquisition of securities seeks to achieve. There appears to be a simple and intuitive answer to this question – it seeks to protect the good faith acquirer's acquisition of *value*. In the certificated context, as will be shown below, the law acts to correct the detriment the defect in question will cause the acquirer. The focus on detriment, as evidenced by the requirements of estoppel, implies a potential patrimonial loss. Thus, it becomes clear that the focus, when dealing with certificated securities, must be on the security asset. In the uncertificated context, on the other hand, the desired outcome is more complex – it serves to protect specific acquirers from patrimonial detriment, but also more broadly to protect the integrity and liquidity of the securities market as a whole and therefore focuses on both the asset and instrument. This implies that, to a certain degree,

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1 The *res iudicata* principle the South African procedural, or adjective, law is also considered erroneously by some to be a form of estoppel (see principally LTC Harms "Estoppel" in WA Joubert et al *Law of South Africa* Vol 18 (3 ed) 2015 § 50-78), and will be excluded from discussion in this work. Accordingly, reference to estoppel in this work should be taken to mean estoppel by representation.

2 1976 (1) SA 441 (A).

the protections of s 53(3) of the Companies Act and s 41 of the FMA have a more depersonalised teleological function in its focus on collective stability rather than individual autonomy, which accounts for the structural differences between those provisions and estoppel.

10 1 Certificated securities and estoppel

The precise legal nature of estoppel is a matter that is not yet settled in South African law – some authorities consider it delictual in nature,[3] others have argued that it flows from an underlying "risk principle" supported by needs of legal and commercial exigency;[4] also, it has been conclusively decided that it could not have been derived from the *exceptio doli*, as this Roman law principle was never received in South Africa.[5]

Though the most convincing account of its nature is an explanation that characterises it as flowing from the foundational private law imperative of giving effect to, and balancing out, the autonomy of legal subjects. This explanation can be summarised as follows.[6]

Legal acts are acts of legal subjectivity to which the law will give effect because (1) they are willed by suitably capable doers, and (2) countenanced by the positive law. However, it may occur that a legal subject exercises her autonomy in a manner that fosters an unfounded belief on the part of a third party in a certain set of facts, and the latter similarly exercises legal subjectivity by relying on those (untrue) facts, leading to that party's detriment. In such cases, the law may on an exceptional basis choose to treat the fiction as fact for its purposes. The *requirements* of the defence of estoppel serve as rules used to discount the relative legal interests of the two parties, allowing the law to make a choice between two horizontally competing manifestations of autonomy. That choice is made on the basis of whether a reliance on the impression created is *sufficiently reasonable to merit legal protection at the cost of others.* It follows that the nature and quality of the conduct giving rise to the representation itself (i.e. the first exercise of autonomy) influences the stringency of the requirements, through which the choice between competing interests is made.

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3 See for instance as originally suggested by JC de Wet *'Estoppel by Representation' in die Suid-Afrikaanse Reg* (1939); NJ Van der Merwe & PPJ Olivier *Die Onregmatige Daad in Die Suid-Afrikaanse Reg* 6 ed (1985) 277-280; or *Scottish Rhodesian Finance Ltd v Taylor* 1972 (4) SA 434 (R).

4 See principally JC van der Walt "Die beskerming van die bona fide-besitsverkryger: 'n vergelyking tussen die Suid-Afrikaanse en Nederlandse reg" in JJ Gauntlet *JC Noster: 'n Feesbundel* (1979) 73-96.

5 See *Bank of Lisbon and SA v De Ornelas* 1988 (3) SA 580 (A).

6 See GF Lubbe "Estoppel, vertrouensbeskerming en die struktuur van die Suid-Afrikaanse privaatreg" (1991) 1 *Tyskrif vir die Suid-Afrikaanse Reg* 1 for what follows.

This explanation demonstrates that the contractual doctrine of objective corrective consensus, the (more recently emerging) notion of ostensible authority and estoppel are all examples of a *higher order* balancing of competing exercises in autonomy in the context of *reliance.* It also explains and ties together the reason all three include an examination of the quality of conduct that created the impression that was relied on.

In that light:[7]

> "[d]ie opvallende kenmerk van die estoppel-leerstuk is juis dat dit dien ter korreksie van verskillende instellings van die privaatreg wat te herlei is tot die ideal van individuele outonomie.
>
> …
>
> In wese kom estoppel in die privaatreg ter sprake waar 'n party gebondenheid aan 'n regshandeling ontken met verwysing na omstandighede waaronder die outonomie-beginsel die oplegging van regsgevolge negeer. 'n Beroep op estoppel trag om hierdie poging te fnuik met verwysing na beleidsoorwegings wat die oplegging van regsgevolge vereis, of met die beroep dat die erkenning van regsgevolge vereis word ter beskerming van die outonomie gestalte van die vertrouende party. Die tegniese vereistes vir 'n geslaagde beroep op estoppel verteenwoordig die uitgekristalliseerde oordeel van die reg aangaande die behoorlike balans tussen hierdie kompeterende beginsels en belange.
>
> In situasies waar die outonomie van die party wat regshandeling ontken die swaarste gewig dra, sou hierdie voorkeur verwesenlik kon word deur die vereistes vir 'n geslaagde beroep op estoppel te verskerp, byvoorbeeld deur die stel van 'n skuld- or streng nadeelvereiste…Hierteenoor staan situasies waar regsekerheid in die verkeer voorrang geniet. Aan so 'n beleidsvoorkeur kan uitdrukking gegee word deur die vereistes vir 'n geslaagde beroep op estoppel te verslap, byvoorbeeld deur weg te doen met die skuldvereiste or nadeelvereiste."

This is vitally important to understanding the role of *fault* in estoppel as it pertains to certificated securities. The currently accepted requirements for showing that a reliance is sufficiently reasonable for it to be protectable is found in the case of vindicatory estoppel. In *Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd*, the court makes the following observations:[8]

> "Our law jealously protects the right of ownership and the correlative right of the owner in regard to his property, unless, of course, the possessor has some enforceable right against the owner. Consistent with this, it has been authoritatively laid down by this Court that an owner is estopped from asserting his rights to his property only –
>
> (a) where the person who acquired his property did so because, by the culpa of the owner, he was misled into the belief that the person, from whom he acquired it, was the owner or was entitled to dispose of it; or

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7 Lubbe (1991) *TSAR* 14 & 16-17.

8 1976 (1) SA 441 (A) 452.

(b) (possibly) where, despite the absence of culpa, the owner is precluded from asserting his rights by compelling considerations of fairness…[the court's further reference to the *exception doli* has been omitted].

See *Grosvenor Motors (Potchefstroom) Ltd v Douglas*, 1956 (3) SA 420 (AD); *Johaadien v Stanley Porter (Paarl) (Pty) Ltd*, 1970 (1) SA 394 (AD) at p. 409.

These two cases relate to estoppel in respect of ownership of movables. There seems no reason for not applying these principles to a case such as the present one where the plaintiff seeks a declaration that it is the 'owner' of shares.

As to the formulation in (b), supra, the occasion has not yet arisen for its further development by this Court. Certainly it does not arise in the present appeal, having regard to the pleadings, the evidence, and the arguments in this Court.

As to (a), supra, it may be stated that the owner will be frustrated by estoppel upon proof of the following requirements -

(i) There must be a representation by the owner, by conduct or otherwise, that the person who disposed of his property was the owner of it or was entitled to dispose of it. A helpful decision in this regard is *Electrolux (Pty) Ltd v Khota and Another*, 1961 (4) SA 244 (W), with its reference at p. 247 to the entrusting of possession of property with the *indicia* of *dominium* or *jus disponendi*.

(ii) The representation must have been made negligently in the circumstances.

(iii) The representation must have been relied upon by the person raising the estoppel.

(iv) Such person's reliance upon the representation must be the cause of his acting to his detriment. As to (iii) and (iv), see *Standard Bank of SA Ltd v Stama (Pty) Ltd*, 1975 (1) SA 730 (AD)."

Most of the points made by the court have, over time, settled into accepted law. However, two key points of consideration merit further discussion. The first is the court's recognition of possible further development of the faultless estoppel in matters relating to holdership of the security asset. The second is whether, in light of the pronouncements in *Electrolux (Pty) Ltd v Khota*[9] coupled with the refinement of the securities concept as found in Chapter 4 of this work, any further insights arise into the law as it relates to estoppel and certificated securities. These issues are related and will be dealt with below in the course of a review of the requirements for estoppel in the context of debt securities.

To further examine these related points, due regard must be had for a further element of the *Oakland* decision:[10]

"company share certificates with blank transfer forms are not, in law, negotiable instruments. There is therefore no basis, in law, for regarding them as being excepted from the principle stated above; although

9 1961 (4) SA 244 (W) at 247.

10 *Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd* 1976 (1) SA 441 (A) 452.

> their transferability, as distinct from negotiability, may, depending on the circumstances, be relevant in considering the question of negligent representation, *supra*.
>
> …
>
> A nominee is an agent with limited authority: he holds shares in name only. He does this on behalf of his nominator or principal, from whom he takes his instructions; see *Sammel and Others v President Brand Gold Mining Co Ltd,* 1969 (3) SA 629 (AD) at p. 666. The principal, whose name does not appear on the register, is usually described as the 'beneficial owner'. This is not, juristically speaking, wholly accurate; but it is a convenient and well-understood label. Ownership of shares does not depend upon registration. On the other hand, the company recognises only its registered shareholders. As indicated in para. (ii) at the commencement of this judgment, it is a practice among brokers of the J.S.E. to have a nominee company. The practice is a convenient one and is accepted as proper by the J.S.E."

The concept of the nominee can now be better understood as instrument-holder – i.e. the person who has holdership of the incidents of execution of a security. This is more than just the role of an administrative agent – the nominee has holdership of one of the two legal objects of which securities comprise. As a result, the instrument-holder: (1) is the only person who may realise and enforce the *content* of the security as rights and other competencies operative between issuer and asset-holder; but (2) *must* do so primarily in the interests, and under the instruction, of the asset-holder. It should also be clear that it is the asset-holder who should be regarded as the "owner" of the securities, being entitled to at least a residual patrimonial interest.

This allows for a far clearer restatement of the requirements for raising a successful estoppel.

First, there must have been a factual representation (by commission or omission) that the legal act that is at issue vis-à-vis the security was lawfully viable. Here guidance can be found in the *Electrolux* case, as cited in *Oakland*, in the context of the vindicatory estoppel:[11]

> It is clear from the authorities in our law, as well as in English law, that the owner's mere entrusting a person (not being a factor, broker, or agent for selling) with the possession of its articles is not sufficient to produce the representation that the *dominium* or *jus disponendi* was vested in the possessor [citing thereafter various authorities including, importantly, *Grosvenor Motors (Potchefstroom) Ltd v Douglas*, 1956 (3) SA 420 (AD) 425E]. The respondent would not be entitled to assume from such mere possession that the possessor was authorised to dispose of the articles. If he made such an assumption he would only have himself to blame for his gullibility.
>
> …
>
> To give rise to the representation of *dominium* or *jus disponendi*, the owner's conduct must be not only the entrusting of possession to the possessor but also the entrusting of it with the *indicia* of the *dominium* or *jus disponendi*. Such *indicia* may be the documents of title and/or of authority to dispose of the articles, as

[11] *Electrolux (Pty) Ltd v Khota* 1961 (4) SA 244 (W) 247.

> for example, the share certificate with a blank transfer form annexed, as in *West v De Villiers*, 1938 CPD 96, and the other cases referred to therein; or such *indicia* may be the actual manner or circumstances in which the owner allows the possessor to possess the articles, as for example, the owner/wholesaler allowing the retailer to exhibit the articles in question for sale with his other stock in trade…"

The functional equivalent of possession in the securities context, as shown in Chapter 4, is *effective control*, manifesting as control over the instrument-holder (which may include actually being that holder). The control in question will depend on the legal question at hand – in this case it refers to the kind of control required to dispose of the asset. Thus, as correctly pointed out by the court, mere instrument-holdership is insufficient in constituting the kind of representation necessary to found a defence of estoppel against a quasi-vindicatory action. What is necessary is to show a representation (ascribable to the asset-holder) that the person who effected the defective disposal had *effective control over the incident(s) of disposal*. A good example, again in the vindicatory context, is possession of blank yet signed transfer forms coupled with the security certificate, as mentioned by the court above. Under the right circumstances, either such transfer forms or merely the certificate itself (as a vital *indicium* of control over the instrument-holder) could create this impression. Nonetheless one should tread carefully when dealing with each set of facts, as one of the key indicators of control in the *Gelria* case was also the fact that the nominee had "nominee" in its name. Each case of alleged representation must, as is required, be carefully evaluated on its merits.

Finally, by way of induction, this can be *generally* restated as a requirement that the representation must have been one of effective control over the incidents pertaining to the estoppel in question. In this regard, the following is a useful guideline on the dynamics of representation of effective control in light of the nature of intangibles augmented by document, but that are not negotiable instruments:[12]

> *"mens [moet] 'n onderskeid tref tussen twee kategorieë van vorderingsreg. Die eerste is die soort vorderingsreg ten opsigte waarvan 'n dokument die enigste bewys is. Dit is waar die vorderingsreg eintlik in die dokument beliggaam word soos byvoorbeeld 'n verhandelbare stuk, waar die reg nie onafhanklik van die dokument kan bestaan nie. Die ander soort vorderingsreg is een ten opsigte waarvan 'n dokument bewys bied, maar nie die enigste bewys nie; die reg bestaan onafhanklik van die dokument. 'n Voorbeeld van so 'n vorderingsreg is juis 'n andeel in 'n maatskappy. Die aandelesertifikaat is wel* prima facie *bewys dat die geregistreerde aandeelhouer wie se naam daarop verskyn die reghebbende is, maar hy mag in werklikheid nie die sogenaamde "*beneficial owner*" wees nie, maar slegs laasgenoemde se genomineerde (Standard Bank v Ocean Commodities,* supra*, te 289AC). Of hy mag, soos Botha beweer Fick gedoen het, sy regte al vervreem en oorgedra het en nie eers 'n genomineerde wees nie. Anders as in die geval van*

12 *Botha v Fick* 1995 (2) SA 750 (A).

grond kan daar dus, ondanks die inskrywing in die register, ondersoek word wie die werklike reghebbende is: Randfontein Estates, supra, te 982."

Second is the possible application of a requirement of fault. Here it must be considered whether faultless estoppel is possible with respect to securities. The point of departure in vindicatory estoppel cases appears to skew in favour of fault, as recently further entrenched by the Supreme Court of Appeal in *Absa Bank Ltd v Knysna Auto Services.*[13] Some analysis based on first principles is necessary in order to determine whether the requirement as laid out in *Oakland* and applied in *Knysna Auto* is indeed correct. The question that needs to be asked, in light of the discussion at the start of this section, is whether the *autonomy of the estoppel-denier* (i.e. in seeking an application of the ordinary principles of law) should outweigh the estoppel-raiser's desire for *legal certainty* (i.e. a corrective overriding of those ordinary principles favouring the expression of her autonomy).

In the context of securities, and debt securities in particular, this is not an easy question. It must be noted, also, that this does not hinge on the quality of the intent or negligence of the representor as estoppel-denier. Rather, it is a *prior* inquiry into the nature of the transaction in question. It must depend, as a matter of policy and principle, on both the general nature of such transactions as well as the character of the particular transaction in question. Its outcome, in turn, will determine whether a secondary inquiry into the state of mind of the representor is necessary or not – i.e. whether fault is a requirement.

Here one might want to outline three different typical transactional contexts for some further insight. First is the very private buying and selling of typically lower-value debt securities found in smaller, more intimate business environments. Second is the buying and selling of sub-investment grade debt securities in the so-called leveraged finance (i.e. non-investment grade debt) environment, where frequency and size of debt securities transactions, size of businesses, and the value of individual debt securities is quite variable. Third is the buying and selling of investment grade securities, where businesses are typically public and very large. Each of these contexts indicates a spectrum of transactional complexity, a spectrum of skill and knowledge on the part of the parties involved, and a spectrum of value, or size, of the transaction (and thus potential loss).

Each of these contexts is to some extent similar to two classical, yet divergent, cases of estoppel – vindicatory estoppel and discounting estoppel. They resemble the vindicatory estoppel, which mostly requires fault, due to the protection against rightful recovery of asset-holdership ("ownership") of a

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[13] (unreported, SCA case no 266/2015, [2016] ZASCA 93, 1 June 2016) at [16]. See also JL Yeats, R de la Harpe, R Jooste, H Stoop, R Cassim, J Seligmann, L Kent, R Bradstreet, RC Williams, MF Cassim, E Swanepoel, FHI Cassim & K Jarvis (2018) *Commentary on the Companies Act of 2008* 2-854 & n 377.

movable *merx*. Yet they also resemble the discounting estoppel, which mostly does not require fault, as they ultimately entail the trading of discounted debt.

As noted, vindicatory estoppel traditionally requires fault. On the other hand, in the discounting cases, faultless estoppel is traditionally asserted because (1) an *intentional* act by a third party occurred, which (2) was *unintentionally enabled* by the estoppel-denier because the latter "armed [the former] with a document which was used to mislead the other party to action".[14] Depending on the context, this third party may be an instrument-holder, or some institutional intermediary to the transaction (as is most often the case in the second and third transactional contexts sketched above).

Yet contrary to the traditional justification provided by the courts,[15] a more nuanced understanding of the doctrine of estoppel as discussed above, points to a simpler and more objective question that can be asked (of any instance where estoppel is raised in the securities context) as to the need for a fault requirement or not – the reasonableness of the reliance. This approach, directly aimed at the higher-order reliance principle of which estoppel is a manifestation, suggests looking to the *context of the transaction* to determine whether a methodology inclusive of fault, or one exclusive of fault, should be used to discount the competing interests of the parties.

When examining this question, the suggestion made by Lubbe is to ask whether the representation was "made intentionally in order to induce a reaction on the part of the representee",[16] and if so, to do away with the fault requirement. However, in the complex financial environment of debt securities and their attendant policy considerations, it is submitted that there may be another criterion which better distinguishes cases requiring an inquiry into fault from those which do not: the "sophistication" of the representee (i.e. her knowledge and skill). Considering the financial environment in which debt securities operate, it is submitted that the *expected ability to assess*, and if necessary to combat, conduct aimed at inducing a specific reaction on the part of the counterparty is the better measure. Virtually all securities transactions will involve conduct aimed at inducement (in the plain language sense) to transact and so, once again, commercial law requires a slightly different articulation of the underlying reasonableness of the estoppel-outcome.

This line of reasoning is not to be confused with the approach of cases such as *Connock's (SA) Motor Co Ltd v Sentraal Westelike Ko-Operatiewe Maatskappy Bpk*[17] or *Monzali v Smith*.[18] These cases seem to suggest that the reasonableness of the conduct of both representor and representee

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14 *Credit Corporation of SA Ltd v Botha* 1968 (4) SA 837 (N) 838 & 850, as well as *Trust Bank van Afrika Bpk v Van der Walt* 1962 (1) SA 174 (T). See also Lubbe (1991) *TSAR* 6-7.

15 Informed mainly by the "facilitation theory" – see Lubbe (1991) *TSAR* 7 & n 49 specifically.

16 Lubbe (1991) *TSAR* 21 ["Summary"].

17 1964 (2) SA 47 (T).

18 1929 AD 382.

need to considered on the facts. The approach suggested is closer to the court's characterisation of the English law position – i.e. as per the *Connock* case that:[19]

> "[t]he reasonable man postulated by the objective test in English law is one in the position of the representee and not the representor."

However, the suggested approach does not emulate the English position, it merely draws from it. The position taken here is that the sophistication of the *representee* will determine whether the quality of the conduct of the representor is at issue or not. This is much more in line with the preferred explanation of South African estoppel as discussed above – a policy-aware *a priori* evaluation of the factual matrix to determine the stringency of the requirements for a successful defence of estoppel (and consequently the upholding of an erroneous reliance as reasonable despite the objective law otherwise not countenancing it).

Thus there is an argument to be made out that the need of an "unsophisticated investor" for legal simplicity, predictability and ultimately certitude in her securities transactions outweighs the asset-holder's entitlement to rely on the operation of the more complex ordinary principles of law. Conversely, where a more sophisticated investor requires the defence of estoppel regarding a financial transaction relating to debt securities, the opposite appears true – more can be expected of that investor in terms of vetting and understanding a transaction. Additionally, such an investor is also better placed to absorb that loss and pursue a claim in delict, or undue enrichment for the loss.

This distinction allows consideration of the qualities of the person raising the defence, but also a weighing of this against the complexity of the transaction and the adroitness of all its various other participants. It is submitted that an application of mind regarding the relative sophistication of the party in question will generate outcomes which are *predictable*, *consistent*, and (most importantly from a policy perspective) *fair.* This is not to say that the inducement-criterion would be ineffective – it is simply to suggest that in the context of securities transactions, sophistication is a better articulation of the underlying policy considerations.

The third and fourth requirements articulated above in the *Oakland* case warrant no further discussion, as they are uncontentious and well understood in the South African law of estoppel. A valuable supplementary resource to the discussion above may also be found in *Commentary 2008*, under § 51.[20]

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19 *Connock's (SA) Motor Co Ltd v Sentraal Westelike Ko-Operatiewe Maatskappy Bpk* 1964 (2) SA 47 (T) 50.

20 Specifically Yeats et al *Commentary 2008* in "(8) Good faith acquirer and estoppel" at 2-845 – 2-856.

Finally, one must briefly discuss *Makate v Vodacom Ltd*[21] for the assertion of ostensible authority, a fairly recent and new legal mechanism also based on the underlying principle of reasonable reliance. Here, seemingly, no negligence is required, and the majority judgement makes it clear that:[22]

> "estoppel and ostensible authority are different, even though there may be some overlap between them. Ostensible authority is the power to act as agent indicated by the circumstances, even if the agent may not truly have been given the power. Estoppel, as observed in the West, is the rule that precludes the principal from denying that she gave authority to the agent."

The complexities of ostensible authority deserve and require a fuller treatment than is possible here. What is clear, however, is that there may be scope for application of this remedy in the context of the transfer of securities as alternative to estoppel and (perhaps contrary to the majority opinion in *Makate*) that a similar inquiry into the reasonableness of the reliance as a function of the sophistication of the relying party in the context of the transaction would generate results that are consistent with the deeper-order policy considerations of which the remedy is an outflow.

10 2 Uncertificated securities and finality of transfer

Estoppel is not the mechanism by which the good faith, but ultimately defective, acquisition of uncertificated securities is achieved. Instead, a far more drastic, widely applicable statutory measure has been introduced. In the Companies Act, s 53(4) reads:

> "A transfer of ownership in accordance with this section occurs despite any fraud, illegality or insolvency that may –
>
> (a) affect the relevant uncertificated securities; or
>
> (b) have resulted in the transfer being effected,
>
> but a transferee who was a party to or had knowledge of the fraud or illegality, or had knowledge of the insolvency, as the case may be, may not rely on this subsection."

Importantly, the Act's definition of "knowledge" is also couched quite widely, as per s 1:

> "**'knowing'**, **'knowingly'** or **'knows'**, when used with respect to a person, and in relation to a particular matter, means that the person either –
>
> (a) had actual knowledge of the matter; or
>
> (b) was in a position in which the person reasonably ought to have –

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21 2016 (4) SA 121 (CC).

22 [75]. See also Yeats et al *Commentary 2008* 2-845 n 338.

(i) had actual knowledge;

(ii) investigated the matter to an extent that would have provided the person with actual knowledge; or

(iii) taken other measures which, if taken, would reasonably be expected to have provided the person with actual knowledge of the matter…"

Section 53(4) is received into the more generally applicable legal framework of uncertificated securities found in the FMA – specifically, s 41 of the FMA reads:

> "**Acquisition by bona fide transferee** – (1) An entry effected in terms of section 38 or 39 is valid and effective against third parties despite any fraud or illegality that may have resulted in the entry being effected, unless a transferee to the transaction resulting in the entry was a party to or had knowledge of the fraud or illegality.
>
> (2) This section does not modify the order of priorities determined by section 40.
>
> (3) Section 53 (4), (5) and (6) of the Companies Act applies to an entry referred to in subsection (1) with the changes required by the context."

Read together, these provisions are the domestic invocation of the principle of finality, effecting what is known as'security of transfer in the uncertificated securities market. This was already touched on in Chapters 5 and 8, with the thrust of the principle being described as follows:[23]

> "[a] transfer is secure if the transferee, being a good faith purchaser, is able to retain the transferred asset free from adverse claims."

The conclusions of the relevant analysis in that chapter also bear a measure of repeating here:[24]

> "From a functional-policy perspective, finality of transfer simultaneously protects two discrete elements of the system. On the one hand, it protects the mechanics of the market infrastructure by ensuring transfers of instrument-holdership are irrevocable. This enables the critical capacity for volume and velocity needed by the trading infrastructure itself, ensuring transactions need not be halted, investigated, and possibly reversed (especially if the security in question has changed hands several times after the originally defective transfer). On the other, it protects the value-chain of the market infrastructure by ensuring that transfer of asset-holdership is also irreversible – thus a good faith, and 'for value', acquirer can be assured, assuming the evidentiary basis for such an acquisition is strong, that the acquisition is firm. These two functions are critical to the integrity of the market.
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> …

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23 Benjamin *Interests in Securities* 73. See Chapter 5, § 5 1 3; and Chapter 8, § 8 2 2.

24 Chapter 5, § 5 1 3.

> It would be difficult to assert that this policy position is solely aimed at protecting the position of *nominees* within the system, rather than also the *value chain* of securities transfer itself…by affording the transferee finality of transfer, that good faith acquirers obtain the *benefits* of securities transferred to them, and that trading systems do not have to reverse the flow of value. It is submitted, in this light, that in order for these rules to function properly, "ownership" *must* refer to asset-holdership; conversely, if it did not always mean asset-holdership, a good faith acquirer of value would have to fall back on the difficult remedy of estoppel (as between her and other relevant intermediaries), a state of affairs these provisions seemingly aim to prevent."

In the previous section, it was noted that under the preferred explanation of the nature and workings of estoppel, estoppel, ostensible authority and the contractual doctrine of objective corrective consensus appear to be manifestations of "*die erkenning van 'n vertrouenskomponent in die regshandelingbegrip*".[25] It is submitted that the principle of finality is a fourth demonstrable manifestation of that recognition, though only in a limited sense. As mentioned in the previous section, an analysis of the finality principle seems to indicate that there is a second, more *depersonalised* and objective policy outcome underlying these provisions. The principle functions equally, if not more, to protect the integrity of the uncertificated securities market or markets as a whole. It does so by ensuring that reliance on the debiting and crediting of securities accounts wholly overrides almost all other legal rules which may indicate such entries have to be reversed.

This means that a different approach is required. These provisions do not, like estoppel, discount competing autonomies of individual legal actors. Instead, these provisions serve to balance the private law principle of autonomy (including its reliance-component) as a whole with the competing principle of legal certainty (invoked in furtherance of commercial market efficiency and efficacy). Their effect indicates that legal certainty is the overriding value, such that the point of departure becomes that *all reliance is reasonable,* subject to a certain limited set of exceptions.

Thus, to understand these provisions the question is inverted, becoming one as to when reliance is unreasonable. In performing this analysis, one may return to the first principles articulated in the previous section as a useful analytical framework in better understanding the statutorily provided exceptions – i.e. knowledge of, or participation in, the kind of fraud, illegality or insolvency envisaged.

The first important question is how to reconcile the subtle differences between s 53(4) of the Companies Act and s 41 of the FMA. The former states that a "transfer occurs" despite any fraud, illegality or insolvency, but prevents transferees who were party to, or with knowledge of, such defects from "relying" on the section. The latter states that a "transfer is valid and effective against third parties" despite any fraud or illegality, "unless" transferees were party to, or had knowledge of,

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25 Lubbe (1991) *TSAR* 20.

those defects. Then s 41(3) of the FMA makes the Companies Act provision applicable "with the changes required by the context".

Ultimately, however, excessive peering at the divergent language is unnecessary. The thrust of the provisions is the same – securities account entries are final unless certain exceptions can be proven. Only two important issues arise. The first is should insolvency be read into all applications of s 41? The second question is should constructive knowledge as indicated by the Companies Act's definition similarly be read into all applications of s 41?

From § 8 2 of Chapter 8 and § 9 2 of Chapter 9, the premise of s 53(2) of the Companies Act and s 38-39 of the FMA is clear – quasi-delivery of the security instrument causes transfer, by operation of law, of holdership of the security asset or a limited real right *in securitatem debiti*. In light of the finality provisions, this causes an *irrevocable patrimonial transfer*, which protects the integrity of securities market.

In what ways could insolvency, in accordance with s 53(4)(a)-(b) of the Companies Act, affect the securities or result in the transfer being effected in a manner where, but for the principle of market integrity, that transfer should be reversed? From a purposive perspective, the section is clearly aimed at cases where the insolvency would, or rather should, have led to the transfer's reversal. The Act can be read to make provision for cases where insolvency impaired the validity of transfer because the securities have been affected, as well as where insolvency impaired the validity of the transfer itself. Regarding the former, this could only be a reference to dispositions without value which may be set aside in terms of the Insolvency Act.[26] In so far as insolvency affects the *ius disponendi*, it limits the ability of the estate to transfer that property without receiving sufficient counter-value, preventing detriment to the estate's creditors.

In fact, more generally, it is difficult to imagine a transfer which (1) needs to be reversed in terms of some application of the positive law as it relates to insolvency, *and* (2) which is reversible but not unlawful. Even voidable transactions become retroactively unlawful once reversal has been elected. Thus the reference to insolvency in the Companies Act may simply be tautological and is implied in the FMA's use of the term "illegality". It is contended that "illegality" must be read so that it includes unlawfulness, thereby including criminal *and* civil defects. In the broader context this must be viewed as a sound outcome, and it allows this first issue to be sidestepped.

The more difficult issue is whether the definition of "knowledge" of the Companies Act should be generally applicable by virtue of s 41(3) of the FMA. The term is not defined in the latter Act, and importing the former Act's definition would widen the scope of challenges to finality of transfer by

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[26] 24 of 1936.

including constructive knowledge also. Here it must be remembered that only prior knowledge, including perhaps constructive knowledge, would suffice to have an entry reversed.

If a transferee were party to a form of transfer-prohibiting fraud or illegality (inclusive of insolvency), the law states that reliance on the records of the applicable securities account or securities accounts becomes unreasonable, and the true asset-holder's volition in seeking recovery of the securities overrides the need for certainty and market integrity. If a transferee had actual knowledge of a form of transfer-prohibiting fraud or illegality (and by implication insolvency), the same reasoning applies.

Thus, it would appear that the most sensible manner in which to resolve this interpretive difficulty is to similarly ask whether policy dictates that legal certainty in uncertificated securities transfers should be overridden where, as per s 1 of the Companies Act, a transferee:

> "(b) was in a position in which [she] reasonably ought to have –
>
> (i) had actual knowledge;
>
> (ii) investigated the matter to an extent that would have provided [her] with actual knowledge; or
>
> (iii) taken other measures which, if taken, would reasonably be expected to have provided [her] with actual knowledge of the [fraud, illegality or insolvency]…"

This brings one back to the analysis of the previous section and its resolution through the use of the "sophisticated investor" test to determine whether fault should be included in the requirements for a valid defence of estoppel. Making use of the sophisticated investor construct could provide a sound basis for determining what reasonable steps would be on the part of the transferee to gain knowledge of the soundness of the transaction. It could, thus, provide the application of the law with a broader spectrum of options to effect an inherently fair *and* economically efficient outcome.

But what would its effect be on number of reversals that could potentially be affected and, thus, on the stability of the market? Here it must be remembered that s 41 extends to transfers of securities as well as transfers of limited real interests in securities, in markets where the use of securities as collateral is a vital component of the financial system. Ultimately, this line of inquiry cannot be resolved here. Its resolution would require more empirical evidence than is available in the course of this work and must be left unanswered.

What has been illuminated, however, is that there are measurable criteria for determining when reliance is unreasonable in this context, and that inclusion of constructive knowledge cannot unduly impair the stability of the financial system in so far as the securities markets are concerned.

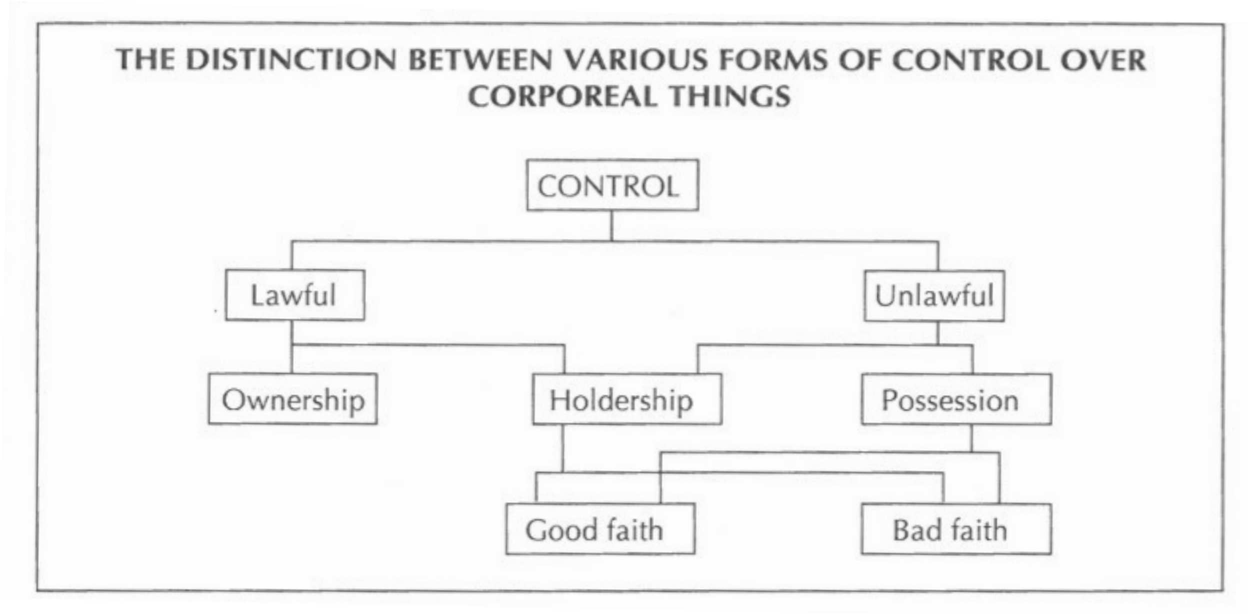
CHAPTER 11

11 The protection of holdership

In this chapter two important mechanisms for the protection of security-, asset- and (potentially) instrument-holdership will be discussed: the contentious *quasi*-spoliation construct as suggested in *Tigon v Bestyet Investments (Pty) Ltd*[1] and the *quasi-rei vindicatio*.

More than anywhere else in this work, this chapter attempts to abandon the doctrine of (quasi-) possession and embrace, through the outcomes of § 4 3 2 2 of Chapter 4 and indeed Chapter 4 generally, a doctrine of effective control. Its structure is outlined, for corporeals, by Van der Walt & Pienaar as follows:[2]

> "the distinction between ownership, possession and holdership is explained with reference to lawfulness and the intention of the controller in each case…ownership and lawful holdership [all other real rights] are lawful forms of control, whereas possession and unlawful holdership are unlawful forms of control.



> …"

[1] 2001 (4) SA 634 (N).

[2] AJ van der Walt & GJ Pienaar *Introduction to the Law of Property* 6 ed (2009) 179-180.

As a result, this chapter in many instances challenges commonly held views on the nature and workings of these remedies. Its analysis attempts to use the theoretical framework developed in this work to push some of the boundaries of contemporary securities law, and to outline a view that is underpinned by a clearer set of first principles.

11 1 *Quasi*-spoliation and rectification

The *mandament van spolie* is a complex, exhaustively debated, and often contentious legal concept in South African law. Its extension, by way of the so-called quasi-spoliation construct, to the deprivation of quasi-possession of incorporeals, is similarly difficult. It is not possible, or appropriate, to deal with all its theoretical and judicial aspects here. The purpose of this section is simply to critically re-evaluate the dicta of *Tigon* and its subsequent treatment by the courts and relevant authorities, doing so against the refined view of holdership and effective control of securities developed in Chapter 4.

In *Tigon* it was held that deprivation of quasi-possession of shares could amount to spoliation and thus could be subject to a spoliation order. The salient aspects of the judgment read, somewhat extensively, as follows:[3]

> "the key issue for determination in this appeal is whether, through the removal of Bestyet's name from Tigon's share register, any form of 'possession' or 'quasi possession' or 'dispossession' is in issue.
>
> …
>
> The right which Bestyet claims has been infringed is the right to be reflected on the register of members as the holder of the shares. The removal of the name does not deprive the holder of any form of possession, nor has the holder been deprived of any right relating to possession.
>
> The rights of a shareholder are personal rights and not real rights and the keeping of a register of members is a statutory requirement which merely reflects prima facie evidence with regard to the listed members of the company. The claim which is sought to be enforced is not one for restoration of physical possession but for restoration of incorporeal non-servitutal rights not capable of being achieved through the *mandament van spolie*.
>
> …

3 640 & 642-643 [own emphasis].

> It seems to me that a distinction (not always recognised) may be drawn between the share itself, which is an incorporeal moveable entity, and the bundle of personal rights to which it gives rise. The argument that we are here dealing with purely personal rights to which the protection of the *mandament van spolie* does not extend is, therefore, not correct. The incorporeals, consisting of the shares, are, by statute, movable property and possession is exercised by the holder negotiating, pledging, bequeathing or otherwise dealing in the shares. *The holder also exercises possession by being registered in the register of members and thereby being able to vote and receive dividends.*"

By characterising entry onto the members' register as quasi-possession of shares, the court purported to extend, at least in theory, the application of quasi-spoliation to the deprivation of quasi-possession of non-servitutal incorporeal rights. This case has been subjected to marked criticism.

The most obvious is that, even according to the authorities cited in the judgment, "[t]he remedy…is limited to instances where the exercise of a right is so closely connected with possession of corporeal property that the loss of the right can be regarded as an infringement of possession of the corporeal object itself."[4] Indeed, subsequently, the courts have seemed to affirm this need for "corporeal-adjacency"[5] in the application of quasi-spoliation (or conversely, its limitation to servitutal incorporeals). Specifically, the High Court's reliance on the extension of the remedy to non-servitutal rights in *Xsinet (Pty) Ltd v Telkom SA Ltd*[6] was overturned by the Supreme Court of Appeal in *Telkom SA Ltd v Xsinet (Pty) Ltd.*[7] In that case, with reference to a number of authorities, the court remarked as follows:[8]

> "[It was argued that] the quasi-possession of the right to receive Telkom's telecommunication services consisting of the actual use ('*daadwerklike gebruik*') of those services must be restored by the possessory remedy. This is, however, a mere personal right and the order sought is essentially to compel specific performance of a contractual right in order to resolve a contractual dispute. This has never been allowed under the *mandament van spolie* and there is no authority for such an extension of the remedy. See, for example, *Zulu v Minister of Works, KwaZulu, and Others*; Van der Walt 1989 (3) THRHR 444 at 449; Kleyn 'Possession' in Zimmerman and Visser *Southern Cross: Civil Law and Common Law in South*

4 640, citing *Zulu v Minister of Works, KwaZulu, and Others* 1992 (1) SA 181 (D) 188H; *Plaatjie and Another v Olivier NO and Others* 1993 (2) SA 156 (O) 159I-160G; and *Shoprite Checkers Ltd v Pangbourne Properties Ltd* 1994 (1) SA 616 (W) 619J-620D & 622B.

See also AJ van der Walt & PJ Sutherland "Dispossession of incorporeals or rights – is the mandament van spolie the appropriate remedy?" (2003) 15 *South African Mercantile Law Journal* 95 97-100 for an invaluable summary and analysis of the application of case law authorities to that effect.

5 As briefly discussed also in Chapter 4, § 4 3 2.

6 2002 (3) SA 629 (C) 637F-G & 638H-J.

7 2003 (5) 309 (SCA).

8 314 para [14].

Africa (1996) at 830; Harms in Joubert (ed) *The Law of South* Africa vol 11 (1st re-issue) para 343 fn 4 at 305; and Sonnekus *Sakereg Vonnisbundel* 2nd ed at 168."

On the *Tigon, Xsinet* and *Telkom* cases Badenhorst et al provide the following further commentary:[9]

> "The *mandament* has never been used to enforce personal, contractual rights. Since there was no authority for such an extension, the *mandament van spolie* could not be granted under these circumstances. It would thus seem as if incorporeals will be protected if they constitute an incident of possession of a corporeal thing. The question of whether the exercise of such a right is in fact incidental to the corporeal thing would be a question of fact, resulting in each case being dealt with differently."

Crucially, in *Zulu v Minister of Works, KwaZulu*,[10] which together with *Bon Quelle (Edms) Bpk v Munisipaliteit van Otavi*[11] make up the *loci classici* on quasi-spoliation, the court states unequivocally that:[12]

> "If the protection given by the *mandament van spolie* were to be held to extend to the exercise of rights in the widest sense, then rights such as a right to performance of a contractual obligation would have to be included, which would be to extend the remedy beyond its legitimate field of application and usefulness."

Based on the above, it would seem that quasi-spoliation in respect of personal rights as property is dead.

However, could its extension to securities as non-servitutal incorporeals be justified? For very specific reasons it is submitted that use of the remedy in the securities context is not only theoretically justifiable, but eminently necessary.

The one set of impediments to its application in the securities context consists of more technical legal issues. The first is that "the fundamental feature of the *mandament van spolie* (it always relates to corporeal things, whether directly or indirectly) remains as an insurmountable obstacle to its extension where the name of a member is unlawfully removed from the register of members."[13]

The purpose of the quasi-spoliation remedy is to have restored *an incident of* possession of property. In this regard the *Telkom* case articulates this best:[14]

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9 PJ Badenhorst, JM Pienaar, H Mostert & M Van Rooyen *The Law of Property* 4 ed (2004) § 13.2.1.3, 300.

10 1992 (1) SA 181 (N).

11 1989 (1) SA 508 (A).

12 *Zulu v Minister of Works, KwaZulu* 1992 (1) SA 181 (N) 159J-160A.

13 Van der Walt & Sutherland (2003) *SA Merc LJ* 102.

14 See the SCA in *Telkom SA Ltd v Xsinet (Pty) Ltd* 2003 (5) 309 (SCA) 314 & 315 [own emphasis].

> "The leading case on the quasi-possession of incorporeals is Bon Quelle (Edms) Bpk v Munisipaliteit van Otavi (supra).
>
> …[which] describes the nature of the quasi-possession of a servitude as follows:
>
> > ''n Onliggaamlike saak soos 'n serwituut is natuurlik nie vatbaar vir fisiese ''besit'' in dieselfde sin as wat daardie uitdrukking gebruik word met betrekking tot liggaamlike sake nie, maar wel vir *quasi-possessio* wat bestaan uit die daadwerklike gebruik van die serwituut. (Waar ek later in hierdie uitspraak die uitdrukking ''besit van 'n reg'' gebruik, bedoel ek dit in hierdie sin). In die samehang van die *mandament van spolie* neem, soos later sal blyk, die daadwerklike gebruik van 'n beweerde serwituut die plek van die besit van 'n liggaamlike saak.'
>
> …
>
> In my opinion the learned Judge was not correct in concluding on the facts that the use of the bandwidth and telephone services constituted *an incident of Xsinet's possession of its premises*."

Up to this point it has been implicitly assumed that the operative scope of quasi-spoliation must, accordingly, be in relation to an incident of possession flowing from holdership of a servitude (most typically the servitutal incident of use). However, it has convincingly been argued[15] that the applicability of quasi-spoliation should not be limited to the context of incidents of servitutal possession only – rather that it should be limited to restoration of disturbed *physical possession*.[16] Thus, as argued in Chapter 4,[17] the factual, and technically incorporeal, incident (rather than right) must for present purposes exhibit an "adjacency" to a corporeal thing.

A deeper understanding of the legal nature of securities has a marked impact on correctly interpreting this position. The court in *Tigon* avers that "[t]he holder [of a share]…exercises possession by being registered in the register of members and thereby being able to vote and receive dividends" and a similar view is expressed in *Commentary 2008*, in which the authors state that "[t]raditionally, registered title has been regarded as comparable to 'quasi-possession'".[18]

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15 See generally AJ van Walt "Toepassing van die Mandament van Spolie op Onroerende Sake" (1986) *Tydskrif vir die Suid-Afrikaanse Reg* 223; Van der Walt & Sutherland (2003) *SA Merc L J* 97-100.

16 AJ van Walt (1986) *TSAR* 223 – "*die duidelike uitgekristaliseerde vereistes vir die verlening van hierdie remedie verseker juis dat dit slegs toepassing kan vind waar daar op die een of ander wyse van die onregmatige en eieregtige versteuring van fisiese beheer oor 'n saak sprake is*."

17 § 4 3 2.

18 *Tigon v Bestyet Investments (Pty) Ltd* 2001 (4) SA 634 (N) 643; and JL Yeats, R de la Harpe, R Jooste, H Stoop, R Cassim, J Seligmann, L Kent, R Bradstreet, RC Williams, MF Cassim, E Swanepoel, FHI Cassim & K Jarvis (2018) *Commentary on the Companies Act of 2008* 2-669 (but also echoed elsewhere).

It is contended that this is incorrect. Instead, as shown in § 4 3 2 2 of Chapter 4, an asset-holder exercises effective control over the patrimonial contents of a security through control of the instrument-holder.[19]

Despite its unintuitive appearance, this construct of effective control is a more functional and robust concept that so-called *quasi-possessio*, with more consistent and useful outcomes (as demonstrated throughout Part 2 of this work). Effective control (as a legal fact) can only be lost if *actual factual* control over the instrument-holder is lost. As a factual construct, this would need to be determined on the basis of the particular set of facts, for the specific purpose it is being determined.

This can happen, informed by the diagram outlined by Van der Walt & Pienaar as in § 11 above, by replacement of the instrument-holder by a person who, *bona* or *mala fide*, refused to adhere to the asset-holder's directives. However, it can also be lost in the case of an instrument-holder "gone rogue", who has (again *bona* or *mala fide*) acted in a manner which indicates that she will no longer act to exercise the security's incidents of execution on behalf of and in the interests of the asset-holder. Thus, a change in names in the securities register may be the *effect* of a quasi-spoliation order, but it is not the *outcome*. The desired outcome of such an order would be the restoration of effective control over the affected incident-functionalities in question to the asset-holder, in whatever manner appropriately achieves this.

This also far better accords with the well-established principle that "[quasi-]possession exist[s] in the *exercising* of a professed right and that it [is] not necessary for the applicant to prove the existence of his right as such, as this would be contrary to the principles of the *mandament van spolie.*"[20]

This is somewhat of a departure from currently accepted views.

First, it is counter to the currently held view that the mandament can only, and should only, be brought by the person who has been removed from the register (i.e. whose instrument-holdership has been dispossessed). It is argued, however, that upon closer examination of the relevant first principles[21] it becomes clear that instrument-holdership and effective control (*quasi-possessio*) are not the same, and that what must be restored is therefore not lost instrument-holdership, but rather lost control,

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19 Unless the asset-holder is also instrument-holder – then control exists through *security*-holdership. Even in this case it would be making a theoretical mistake to state that control flows from instrument-holdership (i.e. registration). Control in these cases flow from being asset- *and* -instrument-holder, as a mere instrument-holder does have factual control over another's security asset unless that control is usurped – see Chapter 4, § 4 3 2 2.

20 As per Badenhorst et al *Property* § 13.2.1.3, 297 [own emphasis] and numerous authorities cited in n 105 & 106; as well as specifically B*on Quelle (Edms) Bpk v Munisipaliteit van Otavi* 1989 (1) SA 508 513-514.

21 Most importantly that the exercise of the incidents of execution (residing in the instrument and therefore bestowed upon its holder) is *lawfully* constrained by the directives of the asset-holder, but may *factually* be exercised outside the boundaries of those directives in manner quite similar to the exercise of the incidents of possession of a corporeal thing that has been spoliated.

however that restoration may be achieved. Moreover, this enables (as discussed below) a useful distinction between rectification and the mandament.

Second, it may practically be a moot point to argue that the restoration of control may take other forms than the replacement of the spoliating instrument-holder (as this is the easiest and most common manner in which to restore effective control), but the restoration of control by other means must at least be recognised as a theoretical possibility flowing from the demonstrable fact that *lawful* instrument-holdership and *factual* control cannot be equated with one another.

This is an important respect in which *Tigon* is deeply flawed. While it is true that "possession is exercised by the holder negotiating, pledging, bequeathing or otherwise dealing in the shares [or other registered securities]", that "possession" is in fact exercised by the *asset*-holder *through* the instrument-holder. Thus it is patently incorrect to assert that "[t]he holder also exercises possession by being registered in the register of members and thereby being able to vote and receive dividends."[22] Instead, the true *de facto* and proper controller (the holder of the incidents of enjoyment) has control through control of the instrument-holder, unless that control is factually usurped or lawfully (and partially) given away through the creation of limited real rights such as pledge or usufruct over the security.

There has been, because quasi-possession is a factual construct, an inherent importance attached to instrument-holdership (i.e. *registration*) within the approach of the law up to this point. However, one can now come at the problem with the understanding that (1) the security asset and instrument are separate legal objects in the true sense, capable of separate holdership, and (2) on that basis, control of the incidents of enjoyment is exercised through the instrument-holder, but by the asset-holder. This allows one to move away from the "sham concept"[23] of *quasi-possessio* and the legal contortions historically required for its application in this context, toward a sharper discussion of the factual control-dynamics that should serve as the basis for an application of the mandament.

While this significantly clarifies the first principles which would hypothetically apply to the remedy in context, it does not quite surmount the problem that the incorporeal in question must seemingly be corporeal-adjacent. There are two implicit lines of reasoning that underlie this requirement. The first is that the *mandament* is paradigmatically, or systematically, remedy that is a function of the law of property, as primarily concerned with *things.* The second, related to the first, is that to extend the quasi-spoliation remedy to personal rights would confuse or conflate it with the contractual remedy of specific performance and, perhaps, with other remedies found in the law of obligations that enable

22 *Tigon v Bestyet Investments (Pty) Ltd* 2001 (4) SA 634 (N) 642-643.

23 Translated from "*drogbegrip*" – Lubbe (1989) *THRHR* 492 n 42.

the enforcement of personal rights. This second line of reasoning is evident in the pronouncements of *Telkom SA Ltd v Xsinet (Pty) Ltd*[24] and *Zulu v Minister of Works, KwaZulu*.[25]

The first of these lines of reasoning can be dealt with speedily. There is no true consensus on the exact nature of the *mandament van spolie*, but there is agreement that restoring "despoiled possession" is its function.[26] As already discussed in Chapter 4 the contours of the remedy, as well as of the notion of possession on which it is founded, prompted AJ Van der Walt to recognise that there are aspects to subject-object relationships which do not relate to substantive rights as such, and a recognition of other subjective relationships is necessary to offer an acceptable explanation of the existence and protection of subjective relationships which are not subjective rights.[27] This recognition enables the development of the notion of "effective control", thoroughly dealt with in § 4 3 2 2 of that chapter. This provides a useful manner in which to understand "possession" of securities.

More importantly for these purposes, Van der Walt convincingly posits that the *mandament* cannot necessarily be considered a phenomenon of the law of things, because possession itself (as a substantive yet wholly factual construct) is not a purely law of things-related issue. Instead, it appears to function to protect possession as a "private law relationship" not reducible to a private law right or any dimension thereof.[28]

But this does not, automatically and without more, make a case for the remedy's application to securities. Thus, the second line of reasoning must be dealt with – the infringement on the territory (and remedies) of the law of obligations. It is submitted that as a point of departure, this line of reasoning is correct and the mandament should not be extended to "dispossession" of obligations. A spoliation order would no doubt be tantamount to an order for specific performance if the entitlement of determination were held by the applicant, and would indeed be a summary order at that.

However, in cases where the splitting of the components of the creditor's interest has occurred, this reasoning breaks down. In these cases, a person with a patrimonial interest in an obligation does not have the entitlement of determination with respect to the right, and therefore the ability to obtain

[24] 2003 (5) 309 (SCA) 314 para [14].

[25] 1992 (1) SA 181 (N) 159J-160A.

[26] AJ Van der Walt "The doctrine of subjective rights: a critical reappraisal from the fringes of property law" (1990) 53 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 316 321, and a legion authorities cited in 42.

[27] Van der Walt (1990) *THRHR* 325. See also Chapter 4, § 4 1.

[28] This is the overall point made in Van der Walt (1990) *THRHR* 316, which has been accepted in this work, mainly via Chapter 4, as valid (at the very least in so far as the property law aspects of obligations are concerned).

an order of specific performance is not juridically available to her. There are only three currently conceivable instances where this may occur: (1) the pledge *in securitatem debiti* of obligations; (2) the granting of a different limited real interest (for example a personal servitude such as a usufruct) over an obligation; and (3) scenarios involving the *ab initio* dichotomous structure of securities. Such cases move the issue beyond the realm of the law of contract and indeed also the law of obligations, as the dynamics of *holdership* of individuated and proprietary legal objects, gleaned from personal rights, are at issue.

Those kinds of separated holdership adhere more to principles of property law and in this context become a function of effective control as factual control coupled with a particular state of mind. This is also supported by the notion that unlike the entirety of an obligation, *specific incident-functionalities* can indeed only be held by one particular person at a particular time. This also supports the Supreme Court's seeming exclusion of the application of the *mandament* to settle contractual issues.[29]

As has been adequately demonstrated, in line with the paradigm of effective control outlined by Van der Walt & Pienaar,[30] effective control over an incident can be lawful or unlawful, and *bona fide* or *mala fide*.[31] Thus in these scenarios, it should be clear that effective control over an incident-functionality of the obligation may be unlawfully usurped, in good or bad faith, by the holder of the entitlement of determination. One example is a pledgee who continues to collect and consume a debt after the principal obligation has been settled. The best example, however, is the "rogue" instrument-holder factually acting outside the bounds of the relationship between her and the asset-holder.

Central to this argument, in the context of securities, is the notion that securities have an enhanced proprietary dynamic and for certain purposes can be understood in a manner more akin to things than other obligations.[32] Where securities are concerned, holdership of the *asset* as the means to enjoy the applicable performance(s) is equally, if not more, important than the actual performance to which it entitles the holder. Securities may not be corporeally-adjacent, but as incorporeals they uniquely exhibit many of the characteristics of property ordinarily associated with *things*. Quite simply, while not associated with possession of a corporeal thing, it is contended that securities are indeed *sufficiently proprietary* in nature to militate in favour of the application of a quasi-spoliation

29 *FirstRand Ltd t/a Rand Merchant Bank v Scholtz NO* 2008 (2) SA 503 (SCA) para. [13], noting importantly that "The *mandement van spolie* does not have a catch-all function to protect the *quasi-possessio* of all kinds of rights irrespective of their nature."

30 See the diagram quoted above in § 11.

31 Chapter 4, § 4 3 2 2.

32 As outlined in Chapter 4, § 4 3 2 generally.

order to restore *effective control*. This may or may not, from a theoretical standpoint, take the form of registration in the securities register.

This brings one to the final element of the technical set of impediments to its application – the notion that rectification is the more appropriate remedy in the circumstances where the *mandament* is sought to be applied.[33]

Rectification is best understood first with reference to s 115 of the Companies Act 61 of 1973. It is not within the scope of this work to provide an exhaustive analysis of the remedy (and the myriad of technical complexities to which it is subject under the regime of the 2008 Companies Act). It is sufficient to be able to provide a concise overview of the remedy as it exists today (against the backdrop of s 115) in order to compare and analyse it against the purer common law spoliation remedy currently under discussion. Section 115(1) provided that:

> "If –
>
> (a) the name of any person is, without sufficient cause, entered in or omitted from the register of members of a company; or
>
> (b) default is made or unnecessary delay takes place in entering in the register the fact of any person having ceased to be a member,
>
> the person concerned or the company or any member of the company, may apply to the Court for rectification of the register."

Thus, rectification under s 115 was concerned with erroneous entry or omission in terms of the register of *shareholders.* The remedy was not *directly* concerned with ownership, so that:[34]

> "[first]…where shares have been registered in the names of persons who are not true owners (for example, for the convenience of the owners), then, if the true owners desire registration in their own names, the proper course is not rectification of the share register, but transfer of the shares into their names. [Second]…where the application for rectification is based solely on the bare assertion of ownership, independently of the ordinary formal requirements for transfer of registration (e.g. s 133 transfer), it is open to question whether a s 115 application is appropriate at all…*It is submitted that s 115 is better limited to a narrow inquiry as to title to registration (comparable to restoration of possession, but different*) *and not a broader competition as to better title (including ownership comparable to a vindication) between the applicant and current person registered in a register*. An unregistered owner has different remedies to

33 See specifically Van der Walt & Sutherland (2003) *SA Merc L J,* § 6, 104-108.

34 Blackman et al *Commentary* 5-314-2, 5-314-4 and 5-324. The authors also note, at 5-314-3 that "our courts have of late either confused the issue [of ownership in contradistinction to title to registration] or decided to take a much looser and broader interpretation of rectification, which is open to criticism."

> procure registration…[But, third, it] has been understood to empower the court (inter alia), if so advised, to determine the ownership of shares, although ordinarily the summary jurisdiction which the provision confers on the court will not be exercised to decide intricate, difficult or complicated issues relating to the ownership of shares."

What must have been demonstrated by the applicant is that the members' register is wrong due to an incorrect entry or omission occurring for whatever reason, including an entry that was correct but has subsequently become incorrect, so that the court, whose power to order rectification is entirely discretionary, is enjoined "to go into all the circumstances of the case and to consider what equity the applicant has to call for its interposition."[35] Thus it has also been stated that its ambit includes "not only putting right something which is wrong on the register, but also an alteration of the register so as to make it reflect the state of affairs which the applicant is entitled to claim that it ought to reflect".[36] The application was a summary one, "which provides a remedy analogous to a spoliation order".[37]

Importantly, the section and the circumstances articulated in ss (1)(a) and (b) were neither "exhaustive of the court's power to order rectification" nor limited the court's power to alter the register or "other registers and returns".[38]

What is clear is that the remedy was aimed at summary, restoration of *instrument-holdership*.

With this background, the first issue that must be settled in terms of the current dispensation is the possible applicability of s 161(1) of the Companies Act ("Application to protect rights of securities holders") as an avenue through which rectification may be pursued. The overall scheme (and indeed title) of the section makes it clear that (1) it is a *rights-based* remedy, and (2) that it does not exclude available common law remedies.

Even if it enables rectification, which it likely does,[39] it should not function as an alternative to the quasi-spoliation remedy, because this statutory and more narrow rectification remedy (as per its title) protects *rights* by restoring *lawful instrument-holdership*, and not *factual control over the instrument-*

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35 See Blackman et al *Commentary* 5-314-4 and 5-322; see also the useful list of examples of instances where rectification has been pursued, provided at 5-314-4 – 5-315.

36 *Orr v Hill* 1929 TPD 885 892.

37 See Blackman et al *Commentary* 5-323 and 5-324.

38 See Blackman et al *Commentary* 5-310-3 & n 2 therein.

39 See compelling arguments made in Yeats et al *Commentary 2008* – which contains an excellent treatment of rectification overall in § 50 – in favour of the use of s 161 at 2-697 – 2-699 & 2-703, including the meaning of "holder" in terms of the section, as well as case law cited therein.

holder. This misconception is particularly muddied by the fact that it is most often *assumed* that a restoration of instrument-holdership amounts to restoration of control over the instrument-holder.

Instrument-holdership relates to the global holdership of the incidents of execution, functioning comfortably within the realm of private law rights. Yet it is not the equivalent of effective control, which is most often (mis)understood as "quasi-possession", and which is a factual construct residing within the superordinate, broader realm of private law rights *and relationships*).[40] Put differently, "s 161(1) could facilitate an application for rectification by a person who qualifies as a holder of securities…provided the application is solely directed at an order determining the right to registered title", but it does not directly and summarily address the factual dimension of *control* in the manner that the remedy of a spoliation order does.[41]

The section also purports not to exclude other common law remedies, opening the door to the rectification remedy developed by the courts under s 115. However, even if one were to accept that rectification, as envisaged in and developed through s 115, is embedded in the common law by virtue of *stare decisis*, there are three further obstacles that militate in favour of distinguishing rectification from the mandament in the current context.

First, because rectification only addresses erroneous entry or omission from the register, it does *not* provide relief to an applicant whose instrument-holder is *correctly* reflected on the register, but who has nonetheless lost control over that instrument-holder, and has therefore lost effective control over the securities in question.

Second, because the common law remedy finds its origins in s 115, it may be that it is only available to holders of *shares* and not to holders of company debt securities. However, this line of reasoning is admittedly somewhat tenuous, as the thrust of the remedy is clearly a correction of what is now, under the 2008 Companies Act, the *securities* register, and may very well be available *mutatis mutandis* to any person concerned with that register.

Third, and ultimately most importantly, even if one were to accept that it is available to persons concerned in respect of any company securities, the principled distinction between restoration of instrument-holdership and restoration of effective control remains. Thus, the better and more

40 Despite the pronouncements to the contrary in *Tigon v Bestyet Investments (Pty) Ltd* 2001 (4) SA 634 (N) at 642-643.

41 As per Blackman et al *Commentary* 5-314-4.

conservative approach remains to regard the rectification as "comparable to restoration of possession, *but different*…"[42]

This leaves only s 163 of the Companies Act, seemingly also allowing rectification on specific grounds. The most important elements of the section read as follows:

> "163. Relief from oppressive or prejudicial conduct or from abuse of separate juristic personality of company – (1) A shareholder or a director of a company may apply to a court for relief if—
>
> (a) any act or omission of the company, or a related person, has had a result that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, the applicant;
> (b) the business of the company, or a related person, is being or has been carried on or conducted in a manner that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, the applicant; or
> (c) the powers of a director or prescribed officer of the company, or a person related to the company, are being or have been exercised in a manner that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, the applicant.
>
> …
>
> (2) Upon considering an application in terms of subsection (1), the court may make any interim or final order it considers fit, including –
>
> …
>
> (k) an order directing rectification of the registers or other records of a company…"

These provisions have been suggested as another manner in which rectification can take place under the Companies Act, although the precise nature and manner in which the remedy functions under the current Act is not settled or certain.[43] Section 163 makes it quite clear that only *shareholders* may avail themselves of this remedy. It follows that holders of what the Act calls "debt securities" or "debt instruments" may, by virtue of the words of the section, not make use of the provision. This essentially means that statutory rectification is unavailable for holders of company debt securities. As should be clear, this is in any event not the kind of rectification that is relevant in discussing the *mandament*.

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42 Yeats et al *Commentary 2008* 2-717.

See also an excellent and lengthy discussion on the role of beneficial ownership and the critical distinctions between *quasi-possession, the right to registration*, the *right to rectify the register,* and the *right to beneficial ownership* at 2-720 – 2-737.

43 See specifically JS (Schoeman) Oosthuizen & PA Delport "Rectification of the securities register of a company and the oppression remedy" (2017) 80(2) *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 228.

However, there is a more fundamental problem with rectification as the appropriate remedy (if it is considered a summary remedy and, more importantly, if it is to be considered as an equivalent or more appropriate alternative to the *mandament*). A more accurate analysis of *quasi-possessio* – i.e. effective control – reveals that rectification may not adequately address the factual state of affairs that a quasi-spoliation order strives to remedy. Rectification by a "shareholder", in the manner provided for by s 163 above, could be read in two ways. First, it could be read as meaning the *instrument-holder* (as the company is not generally compelled to answer to any other person, including an asset-holder). This would limit the scope of application of s 163 even further, and ultimately should not be supported as the remedy is clearly aimed at a *change* in instrument-holdership with respect to equity securities.

Thus, it should in all likelihood be read in a different way – to mean that the *asset-holder* of an equity security may approach the court to effect a change in instrument-holdership. The first problem with this is that by contrast the *mandament* may be used by *any person* whose effective control was spoliated and should not be limited to use by an asset-holder only. Pledgees and other holders of a limited real interest seem the best examples. The policy-function of the remedy is to foster legal-political stability on an interim basis by discouraging persons from resorting to self-help.[44] Rectification on the other hand seems only aimed at enabling an (equity) asset-holder to regain instrument-holdership, or at replacing an existing asset-holder (and probably only on the basis of "oppression", although that need not be further discussed). This leaves any number of lawful or unlawful holders (i.e. controllers) of limited incidents over the security unaccounted for, demonstrating that the scope of an application for rectification is significantly too narrow for it to be equated with a quasi-spoliation order, and these latter scenarios are exactly what the *mandament* is for.

The second problem is that, as noted above, effective control over one of more of a security's patrimonial incident-functionalities, *as a factual construct*, does not rest on the identity of the instrument-holder alone. It also, perhaps even more importantly, rests on the *factual matrix and state of mind* of the instrument-holder vis-a-vis her controller. It further rests on the specific incident-functionality or set of incident-functionalities in question, with most cases pointing to one or more incidents of the class *use and enjoyment*. All that rectification under s 163 might achieve is a change in instrument-holdership, which does not necessarily (but admittedly may often) amount to restoration of effective control of the incident or incidents at issue in the application.

For these reasons, it is inappropriate to state that the kind of rectification that could perhaps be effected through s 163 (which is in any event unavailable to holders of debt securities) is the correct

[44] See below. It should probably be admitted, however, that the remedy is more typically used tactically as one measure of a broader legal strategy, in matters of practice.

remedy to achieve the policy-outcomes ordinarily associated with spoliation of incorporeals. Again, the (now) common law summary rectification as developed through the 1973 Act may well be an available and appropriate alternative to the mandament in this context, but it is not within the scope of this work to explore this issue.

Through a deeper analysis of the *mandament* in light of: (1) the legal nature of (debt) securities, and (2) the more doctrinally and theoretically sound construct of effective control, there appears to be no true technical legal impediments to the application of the quasi-spoliation order in this context. In fact, there is a demonstrable need and clear application for the remedy as a temporary restorer of effective control of a security's underlying patrimonial interest, or an incident thereof.

Finally, to conclude the section, it is perhaps prudent to briefly discuss whether there is a *policy-basis* underpinning this conclusion. A useful starting point is the following:[45]

> "The *Tigon* judgment is totally devoid of any policy argument but it is not difficult to conceive of one for extending the *mandament*. The [Companies Act of 1973] states that an incorrect entry in the register of members may be removed only by rectification, at least where the member does not consent to such removal…It is apparent that Parliament frowns upon self-help in the form of a unilateral removal of a name from the register…Shares [and, it is submitted, other securities] are perhaps the most important asset of our time…
>
> But there are stronger policy arguments against extending the *mandament* to the unlawful removal of a name from the register of members.
>
> The mandament is aimed at protecting the legal order against self-help in situations where self-help can typically spark conflict and violence."

With rectification having been dealt with, the only policy argument presented above for non-extension of the remedy is that its purpose (prevention of violence through prevention of self-help) is not served in this context.

With respect, this greatly oversimplifies the purpose the *mandament* serves. The function of possession that the remedy is typically regarded as protecting, is the so-called legal-political function – a temporary (and often urgent) restitution of the *status quo ante* in furtherance of social, political and legal order and stability.[46] In this light, to reduce the function of the *mandament* to the prevention of violence and to further reduce the concept of violence to physical violence (thereby excluding

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45 Van der Walt & Sutherland (2003) *SA Merc LJ* 103.

46 See AJ Van der Walt "Die funksies en omskrywing van besit" (1988) 51 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 276 288-293 for an excellent and multifaceted treatment of this fundamentally uncertain function of possession.

economic violence) is too narrow. Access to a crucial store of wealth in the modern age cannot be said to be immaterial to legal-political stability. Indeed one need only to extend the policy argument to cover economic violence (for instance in the form of fraud, theft, or embezzlement of the funds or wealth of vulnerable persons such as pensioners) in order to satisfy a value-driven inquiry into its necessity in the context of securities. One may further venture to suggest that the argument also fails to account for the fact that physical violence is very often caused by economic and financial reasons such as may arise from the dispossession of securities without a means for the temporary (and urgent) restoration of control over the patrimony they contain.

Support for this view is also found in *Commentary 2008*, where the authors remark:[47]

> "Surely any form of self-help has the risk of sparking public violence, particularly if it involves the deprivation of valuable property (corporeal or incorporeal), and shares are often far more valuable than corporeal property. In any event, the risk of public violence is not the only policy behind preventing self-help; property rights and the right to have disputes resolved by our courts are today protected by the Constitution. The Supreme Court of Appeal has held that self-help clauses are unconstitutional, for example, in the context of notarial bonds which can involve incorporeal rights. It is therefore submitted that there are very good policy reasons for the courts intervening to prevent self-help.
>
> This extends to any attempt by a company to unilaterally deprive a person of registered title, which is best served by a summary process. Also, the fact that s 115 of the 1973 Act provided specific relief weighed heavily on the conclusions of Van der Walt and Sutherland and the omission of a comparable provision from the Act means that this is no longer a supporting factor with regard to the current position."

Its temporary, and often urgent, nature is a final important factor. It is trite that *mandament* does not require proof of the lawful merits of the applicant's right to restored control.[48] Consider the complexity, resource-intensiveness and potentially slow-moving task of instituting action, or even an application, to recover usurped control to debt security coupon payments through proving a lawful right or entitlement. Such a process could prove wholly inadequate for a plaintiff or applicant who, for example, needs urgent relief to avoid impending insolvency or liquidation, or who needs to cast a vote at an imminent company annual general meeting on matters of great consequence to her investment. Securities have the added characteristic of high liquidity (i.e. they are easily and quickly

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47 Yeats et al *Commentary 2008* 2-712 – 2-713.

48 Yeats et al *Commentary 2008* 2-715 also provides a useful piece of analysis in this regard:

> "In certain circumstances, a summary rectification remedy has some advantages over a *mandament van spolie* in that it is more flexible and is not fixated on restoring the status quo ante, irrespective of the parties' actual rights. As a result, the court can take a broader view when considering the merits; for example, it can consider the company's duty to maintain the securities register in accordance with the Act and the rights of the other shareholders. If correctly applied, this can make it a more sophisticated remedy but one has to be careful that this does not embroil the court in issues that may deny an adequate remedy in the face of self-help. It would be clearly undesirable for self-help to be rewarded because it takes a long time or is very difficult to procure restoration in circumstances where a person has been removed from the register without good cause and without recourse to the courts."

disposable for value), making the prevention of spoliation even more time-sensitive. It is certainly conceivable that issuers would not be interested in, nor be incentivised to become involved in, such disputes.

In this light the second, policy-driven set of impediments to the remedy's application also do not amount to an insurmountable argument against its *limited application to securities* as a somewhat unique form of incorporeal property (but perhaps also to matters of control over other limited real rights in obligations).

In conclusion, this section has shown that an extension of the quasi-spoliation remedy to securities, once the construct and dynamics of effective control as "quasi-possessio" are properly understood, is fully warranted and indeed necessary. The fact that *Tigon* has, seemingly, been referred to or considered in a small number of subsequent judgements also becomes far more palatable.[49]

In a final observation, it should be noted that there seems to be no reason why this remedy cannot be used in the context of both certificated *and uncertificated* securities – a successful application for the remedy need not necessarily cause a change in instrument-holdership (although plainly it mostly does), it must merely restore control over the instrument-holder to the applicant on a temporary basis.

11 2 A case for the explicit recognition of the *quasi-rei vindicatio*

In *Standard Bank of South Africa Ltd and Another v Ocean Commodities Inc and Others*,[50] the Supreme Court of Appeal indicated a willingness to consider an action for the recovery of share and debenture certificates, along with signed transfer forms, as a remedy approximating the vindicatory action. However, the court did not make it clear whether it was explicitly recognising a *quasi-rei vindicatio* outright and appears conflicted throughout the relevant portions of the judgment:[51]

> "Here it is necessary to examine the basis of Ocean's claim and the nature of the defence, or defences, raised in opposition thereto. Before this Court…the respondents…submitted that Ocean was the beneficial owner of the shares and debentures in question; that, as such, Ocean was entitled, prima facie, to be placed in possession of the shares; and that the onus was on appellants to establish some right to withhold possession from Ocean. He stated that in essence Ocean's claim was a vindicatory one.

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49 See Yeats et al *Commentary 2008* 2-690 – 2-691 & specifically n 153.

50 1983 (1) SA 276 (A).

51 288F-289F, 289H-290B, & 294C-E.

> I think that this submission may perhaps over-simplify the position. [Here the court goes on to provide a rigorous and oft-cited analysis on the nature of shares and the similar nature of debentures]…
>
> …I am not sure that in strict law counsel is correct in categorising Ocean's claim for delivery of the shares as a vindicatory one. A share's character as a bundle of personal rights and the fact that neither the Harris brothers nor Ocean at any time enjoyed full and untrammelled "ownership" of the shares (with all the rights incidental thereto) makes it difficult to fit the claim into the mould of the true *rei vindicatio*…Nevertheless, as I shall show, the claim is in some respects analogous to the *rei vindicatio*.
>
> …
>
> There is thus much to be said for the view that the cause of action should be classified, or characterized, as one analogous to the *rei vindicatio* in respect of property situated within the jurisdiction and that in that event the *lex situs* (i.e. South African law) would be the correct *lex causae*."

The origin of this tentative analogy can be found in *Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd*,[52] a case which appears (also implicitly) to lean towards the availability of the *quasi-rei vindication*. As per the court:[53]

> "Although both sides dealt with the case on the footing that the plaintiff's claim was vindicatory, what was claimed was basically a declaration that the shares were vested in Gelria. Although 'ownership' may, juristically, not be accurate in relation to the rights of the person in whom the shares vest, for convenience the descriptive labels of 'owner' and 'ownership' will be retained in this judgment."

Although it cannot be said with total certainty, the hesitation regarding the vindicatory nature of the action gives the impression that the court (1) was inclined to give the action a quasi-vindicatory character, but (2) was prevented from doing so by a doctrinal and theoretical uncertainty as to whether such an approach was defensible.

It is submitted that this work allays uncertainty to the extent that such a claim, to borrow from the phrasing in *Standard Bank* above, can indeed "fit the mould" of the vindicatory action.

Traditionally, invocation of the *rei vindicatio* requires a claimant to prove: (1) ownership of the thing; (2) the existence and clear identifiability of the thing; and (3) possession of the thing by the defendant at the time of the instituting of action by the claimant.[54]

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52 1976 (1) SA 441 (A).

53 447G-H, and also implicit in 246B-G.

54 See Van der Merwe *Sakereg* 236-237 & n 6-16; Van der Merwe "Things" *LAWSA* § 233 & n 9-22; and Badenhorst el al *Property* § 11.21.1, 243-244 & n 22-24.

As to the first requirement, as per § 5 1 3 of Chapter 5, asset-holdership is a more than sufficient construct to be used in place of ownership. Regarding the second requirement, though the security asset is fungible, it is difficult to argue that asset-holdership or co-asset-holdership in a fungible bulk is not identifiable through the demarcatory effect of the security instrument in question. Thus this requirement is perfectly applicable even to securities of the same class and issue, both because they are serially or globally numbered and evidenced by register entry. In terms of the final requirement one must turn to the discussions of § 4 3 2 2 of Chapter 4 and the previous section. From this, it is quite clear that replacement of (quasi-)possession with *effective control*[55] exercised by the defendant *animus domini* is an entirely feasible and coherent approach to this requirement.

This makes plain that an application of the *quasi-rei vindicatio* in the context of securities is viable from a theoretical and practical standpoint. It is, therefore, submitted that the time has come for South African law to recognise, explicitly, the application of the vindicatory action to securities and to do so in the above terms.

The only two issues which may nonetheless affect the viability of this standpoint are the matter of rectification and the effect of the finality of transfer provisions as discussed in § 10 2 of the previous Chapter.

In terms of the first, as outlined in the previous section, the statutory avenues for rectification are s 161 and s 163 of the Companies Act. Both can again be dealt with quite easily. In terms of the former, subsection (2) makes it quite clear that it applies "in addition to" any remedies available in terms either of the Act (read: s 163) or the common law. Yet, perhaps more pertinently, s 161 does not contain any *substantive requirements or prerequisites*. The section merely provides that the court may be approached by a securities holder for: a declaratory order (see ss (1)(a) – "an order determining any rights…"); or an order which proactively shields (see ss (1)(b)(i) – "any appropriate order necessary…to protect any right"), or retroactively addresses harm (see ss(1)(b)(ii) – "any appropriate order necessary…to rectify any harm done…").

Regardless of whether it is more appropriate to read the requirements of the *quasi-rei vindicatio into* proceedings under s 161, or to consider it a free-standing common law remedy, the section does not function to preclude recognition, and pursuance, of a vindicatory action. Finally, it is also not received into the FMA and thus cannot serve the interests of holders of uncertificated non-company securities.

Section 163, on the other hand, is only available to asset-holders of (company) equity securities and only where conduct as outlined in s 163(1)(a)-(c) of the Companies Act has occurred. The outcome of rectification is a substitution of instrument-holders, which may, under the right circumstances,

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[55] As control over the instrument-holder.

have the effect of restoring effective control over the security to the asset-holder (i.e. "owner"). Thus, it would appear that rectification may indeed be used as a means to "vindicate" equity securities.

However, as a means to emulate vindication, its usefulness is obviously bounded. First, the limited applicability of the provision excludes it use by holders of any company securities "other than shares"[56] and it is unavailable to holders of securities not issued by companies. Second, it may only be used where the asset-holder has lost lawful effective control of the security due to very specific types of conduct, and only where that conduct was by the company, a related party or a director of the company, as per s 163(1). Thus the action may be unavailable in cases where an instrument-holder has taken unlawful control of the security as well as where unlawful control has been bestowed on another outside party under the guise of asset-holdership. These kinds of cases are usually where the vindicatory action is most useful. In sum, rectification via s 163 in its current state does not come close to providing a remedial dispensation in which the *quasi-rei vindicatio* is obsolete.

The second issue is the effect of s 41 of the FMA, and by extension, s 53(4) of the Companies Act. Where the exceptions embedded in those provisions are not activated, the vindicatory action will not be available to the asset-holder of an uncertificated security. It is uncontentious to assert that these statutory provisions operate to exclude any conflicting common law rule.

Further, however, the sections prevent a plaintiff from satisfying the requirements of the vindicatory action. Section 41 protects the validity of a register entry, which extends also to transfers of asset-holdership ("ownership") by operation of law. Section 53(4) augments this by stating that a transfer of ownership in this manner will be regarded as having "occurred" despite the listed defects which may retrospectively affect its validity. Thus any person wishing to invoke the vindicatory action will be unable to prove *asset-holdership* in terms of the first requirement of the action.

Nonetheless, what if those exceptions found in the security of transfer provisions are evident and can be proven – i.e. fraud, illegality (which has been shown to include civil unlawfulness) or insolvency? In such cases, the remedy is not only useful, but eminently necessary. The FMA does not provide a free-standing, statutory remedy to a person in cases where a securities account entry is reversible. Instead, s 38 refers to "Chapter 2, Part E of the Companies Act" and, more specifically, s 41(3) refers to s 53(4)-(6) of the Companies Act. In terms of the current issue, only s 53(5) is relevant, stating:

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56 See s 37(5), s 41 and s 43 of the Companies Act.

> "A court may not order the name of a transferee contemplated in this section to be removed from an uncertificated securities register, unless that person was a party to or had knowledge of a fraud or illegality as contemplated in subsection (4)."

The basis for such a court order is not specified. Here company securities must be distinguished from non-company securities. In terms of the former, s 161 and s 163 remain available as a basis for such a court order. However, this has been dealt with above, with the conclusion that in such cases the *quasi-rei vindicatio* would appear to remain available as a manner in which to obtain the court order removing the name of a person from the uncertificated securities register. In terms of non-company securities, the remedy is indispensable as a basis for such an order and an alternative means by which to do so does not seem apparent.

CHAPTER 12

12 Final remarks

It was the aim of this study to:[1]

> “establish a consistent and coherent legal description of the South African positive law as it relates to debt securities…[it] focuses on four core issues: (1) the legal history, (2) the legal nature, (3) the classification, and (4) current legal challenges relating to debt securities.”

This was done using a methodological framework that broadly followed the framework used in DV Cowen & L Gering’s *The Law of Negotiable Instruments in South Africa*,[2] overlaying the above four key elements of the research problem with three of the authors’ four approaches.

First, in terms of the *historical approach*, it laid analytic foundations by analysing the economic and legal history of debt securities in South Africa. Second, using that as foundation, it applied the *analytic-systemic approach* to the current state of the law, coming to a number of strong conclusions with respect to both the legal nature and classification of debt securities in modern South African law. Finally, in terms of the *functional-policy approach*, it brought the outcomes of the previous analysis to bear on a select number of pertinent or contentious issues regarding debt securities in contemporary South African law. Due to the significant scope and breadth of this exercise, as well as the uniquely domestic nature of the legal problem, the *comparative approach* was selectively used to augment – where relevant – these problems, rather than utilised as a free-standing pillar in this dissertation.

Yet a great number of relevant legal areas, topics and problems regarding South African debt securities were not dealt with here.[3] This is not to say these problems are unimportant or do not exist; instead, dealing with issues of general application, and putting the focus on the harmonisation

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1 Chapter 1, § 1 2.

2 See 7-15.

3 Pertinent examples include debt securities and company law (specifically s 43 of the Companies Act 71 of 2008); the use of trust in the issue and holdership of debt securities, the dynamics of secured debt securities.

of the interaction between private law and securities law, was judged the better use of the already considerable volume of this work. A study of debt securities and the Companies Act alone could justify its own stand-alone dissertation. It is hoped that this work, aimed primarily as it is at first principles, can form the basis for further study (and some necessary legislative reform) regarding these and other problems.

What follows, to conclude the dissertation, is a concise overview of the key outcomes of the work.

12 1 Historical outcomes: the commoditisation of debt, English influence, "debentures", and share-centricity in the legislative evolution of securities law

The historical analysis undertaken serves an enabling function – specifically it enables the re-evaluation of current principles (principally driven by statute) against their origins and historical context. This facilitates a better interpretation of the relationship between the statutory and common law principles currently at play; equally importantly, it allows for novel and sometimes contentious positions (both in terms of principles and policy) to be articulated with a stronger and more informed foundation for doing so.

In terms of Chapter 2, the first key insight is from the development of the first proto-debt securities. This development demonstrates an enduring and fundamental feature of (debt) securities – the notion of the "commoditisation" of obligations in order to tap the general public for funds in the financing of large public and (later) private enterprises. In many senses this commoditisation is a heuristic – the debt in which securities are rooted does not necessarily function all that (if at all) differently to ordinary debt. However, the heuristic allows one to think of and deal with that debt more as an *asset* and less as an *obligation* to performance sounding in money.

This is vitally important not only for the constitution and operation of markets and designing of secondary uses and instruments (as seen most prominently in securities' collateral and securitisation functions) based on debt and equity securities, but more locally and importantly for present purposes in that it justifies and drives the enhanced proprietary characteristics of securities. This underpins a great many aspects of this work, most notably the notion of effective control,[4] the more ready application of principles from the South African law of things,[5] and the proposed classificatory approach.[6]

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4 Outlined in Chapter 4, § 4 3 2.

5 As seen throughout Part 2 of this work.

6 Dealt with in Chapter 6.

The second is a proper understanding of the marked English influence on the South African securities system, most importantly: (1) its regulatory approach; (2) the manner in which the role and structure of the banking system impacts on the emergence and development of securities markets; and (3) the legal developments resulting in *registered* securities, which dominate South Africa's financial system in contrast to the bearer securities which dominate most systems making use of a Civilian private law.

The final key insight of the chapter is the lack of debt securities in the early domestic landscape, prevailing essentially until the 1980s, which lays critical foundations for the critical assessment of the *legal developments* that follow in Chapter 3.

Chapter 3 has a number of critical and interdependent outcomes. It demonstrates the principal influence of company law (and its markedly English character) on the overall legal landscape in terms of securities, as well as the reception of the English conception of a debt security ("debenture", but also later "bonds" and "notes") as a "[secured or unsecured] written acknowledgement of debt",[7] as evident in early 20th century legislation. It then outlines the gradual "ascendancy of the securities concept" as a legal signifier for the regulation of shares and debentures during the latter-half of the 20th century, beginning with the Companies Act 61 of 1973 and culminating in the total dematerialisation of exchange-traded *securities* and the (effective) erasure of the debenture concept in the Companies Act 71 of 2008. Within this development one also sees a convergence of the underlying structure of debt and equity securities as *registered* securities, and a corresponding decline in the appropriateness of the above-mentioned definition of debentures.

It further shows that due to the prevalence of equity securities (i.e. shares) in South Africa, the legal focus of this securities concept was mainly on shares but also that this "share-centric" securities concept was at the same time employed to regulate all securities. Thus, although debentures and shares began to look and function in a very similar manner, share-centricity meant the integrity of the legislative framework and common law definition in their application to *debt* securities began to become increasingly questionable (this is particularly demonstrable when dealing with the dematerialisation of debt securities).

This issue – primarily one of legal certainty – occasions a re-examination of the legal conception (a wider inquiry than merely assessing the definition) of debt securities in light of whether there is a set

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7 Blackman et al *Commentary* 5-327. This description is often accompanied, in South African literature, with reference to the classical compendium of English, South African, and Australasian cases: *Edmonds v Blaina Furnaces Co* (1887) 36 ChD 215; *British India Steam Navigation Co v Inland Revenue Commissioners* (1881) 7 QBD 165 172–3; *Levy v Abercorris Slate & Slab Co* (1887) 37 ChD 260; *Lemon v Austin Friars Investment Trust Ltd* [1926] Ch 1 17; [1925] All ER Rep 255 (CA); *R v Findlater* [1939] 1 All ER 82 85 (CA); *Knightsbridge Estates Trust Ltd v Byrne* [1940] AC 613 621–3; [1940] 2 All ER 401 405–6 (HL); *Handevel Pty Ltd v Comptroller of Stamps* (1985) 10 ACLR 207 218 (HC of A); *Austral Mining Construction Pty Ltd v NZI Capital Corporation Ltd* (1991) 4 ACSR 57 58 SC (Qld); and *Re SH & Co (Realisations) 1990 Ltd* [1993] BCLC 1309 1317–18.

of first principles that might govern *all* registered securities and that can be used to (1) revise the legal definition (and classification) of debt securities in South African law, and (2) harmonise the obvious and difficult tension between the received English-law nature of registered securities and South Africa's Civilian private law in more practical legal matters.

12 2 Analytical-systemic outcomes: the asset-instrument dichotomy, holdership and control; the classification of debt securities

Chapter 4 is in many senses the keystone of the study – it answers the question of whether a set of private law-rooted first principles can be identified in respect of South African registered securities. It answers this question in the affirmative, enabling a harmonisation of the securities concept with the Civilian nature of the domestic private law, leading to a full and appropriate understanding of debt securities within the domestic legal system.

It confirms the rejection in South Africa of the English law doctrine of constructive trust (around which English law registered securities, as received domestically, are built), and instead demonstrates that an analysis of the *exercise of legal subjectivity* with respect to the two-fold components of private law rights (i.e. entitlements of determination and enjoyment, or *beskikkings-* and *genotsbevoegdheid*)[8] enables the description of personal rights in terms of subsidiary incidents, flowing from these components.

On that basis it is able to demonstrate that South African securities are comprised of two interdependent, but functionally separate,[9] *legal objects* rather than the two different kinds of ownership (i.e. equitable and legal) of English trust law. The first construct is referred to as the "security instrument". In essence, it is a *locus for (holdership of) the incidents*[10] *of execution* over the underlying interest in a security. It typically manifests as entry of the instrument-holder into the securities register and the issue to that holder of a security certificate; or, in the case of uncertificated securities, merely electronic register entry in the uncertificated securities register. Second is what is called the "security asset". It generally corresponds with the proprietary dimension ascribed by the law to a security – i.e. patrimony as the economic end-benefits of the rights and other competencies

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8 As most pertinently articulated in GF Lubbe "Sessie in securitatem debiti en die komponente van die skuldeisersbelang" (1989) 52 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 485.

9 As mentioned in Chapter 1, this interdependent separateness is not to be confused with the full separation and severability of "registered ownership" and "beneficial ownership" as advocated in JL Yeats, R de la Harpe, R Jooste, H Stoop, R Cassim, J Seligmann, L Kent, R Bradstreet, RC Williams, MF Cassim, E Swanepoel, FHI Cassim & K Jarvis (2018) *Commentary on the Companies Act of 2008*. This will become through the totality of this Chapter and the next.

10 See Chapter 4, § 4 1 explains in more detail how these incidents fit into the overall South African legal system.

contained in a security. It, in turn, is the locus for (holdership of) the incidents which remain after the incidents of execution have been shorn from the underlying interest.

In addition to enabling a far more sensible approach to the meaning of "issue" of securities, this reconceptualisation of the securities concept further allows one to give concrete and detailed legal content to what is traditionally described as the *sui generis* relationship of agency between "beneficial owner" and her nominee (the holder of "registered title") – i.e. a fiduciary agency arising from the underlying *proprietary* structure of asset- and instrument-holdership respectively. It further provides a fully defensible and rational basis for understanding the dynamics of holdership (for "ownership") of and effective control (for *quasi-possessio*) over securities as *assets*. This, in turn, is the key to sounder applications of pre-existing private law principles which are already evident, but deeply uncertain, in the current legal system (which is the foundation for large portions of Part 2 of the study).

Chapter 5 takes the outcomes of Chapter 4 and applies them to the *uncertificated* securities environment. The focus turns away from a rationalisation of private and securities law and addresses a number of difficult and uncertain problems within the *legislative system* that enables uncertificated securities and their holdership. By showing that the putative term "deposit" has a very broad meaning arising from its legislative history, it is able to distinguish and inform from the Financial Markets Act (19 of 2012) the *custodial* and *administrative* elements of the depository system for the "custody and administration of uncertificated securities". From that distinction it is able to make better sense of the manner in which the uncertificated security instrument is "held" and consequently the precise manner in which the co-ownership of the underlying beneficial interest of asset-holders is understood and how it functions (i.e. the dynamics of "ownership" as per that Act and the Companies Act of 2008). It also allows a discussion of the meaning of "interests in securities" as found in the Act and in international parlance, distinguishing the manner in which Civilian (bearer-oriented) and pure English (registered) securities deal with intermediation from the unique manner in which it must occur in the mixed-legal system of the domestic environment.

Finally, in Chapter 6, the particularly difficult issue of how to classify (and therefore identify) debt securities is dealt with. The problem is especially vexing in light of the *eiusdem generis* approach of most legislation dealing with securities, combined with the substantive variability of debt securities themselves and the purposive variability of each act purporting to deal with those securities. Ultimately, it is concluded that a *typological* approach is the only viable methodology to deal with this problem, and it outlines a number of necessary and thereafter possible *indicia* with which to make classificatory determinations (which will drive the application of legal rules) in respect of debt securities.

12 3 Functional-policy outcomes: harmonised application of private law to securities and statutory clarity

The functional-policy analysis makes up Part 2 of the study. It is a policy-aware application of the theoretical framework developed in Chapters 4 and 5 (and supported by the historical insights of Chapters 2 and 3) to a select number of themes and legal issues of the current environment. Principally it shows that the theoretical reconceptualisation of Chapter 4, and the clarity it brings to the uncertificated environment as per Chapter 5, has *actual explanatory and problem-solving* value. It is not deemed necessary to summarise the various outcomes of Part 2 here.

In conclusion, it is hoped that this work has improved and rationalised our understanding of the legal nature of debt securities in South African law and further that, in so doing, it has provided some much needed clarity to the broader field of securities law. It is further hoped that the framework of incidents analysis developed in Chapter 4 and applied throughout Part 2 of this work may assist in coming to grips with the far greater and more complex problem of the relationship between the law of things and the law of obligations.

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